India's FDI Inflows: Trends and Concepts

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Trends & Concepts

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CONTENTS

List of Charts

List of Boxes and Diagrams

List of Annexure

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K.S. Chalapati Rao and Biswajit Dhar[*]

*[**Abstract**: India's inward investment regime went through a series of changes since economic reforms were ushered in two decades back. The expectation of the policy makers was that an "investor friendly" regime will help India establish itself as a preferred destination of foreign investors. These expectations remained largely unfulfilled despite the consistent attempts by the policy makers to increase the attractiveness of India by further changes in policies that included opening up of individual sectors, raising the hitherto existing caps on foreign holding and improving investment procedures. But after 2005-06, official statistics started reporting steep increases in FDI inflows. This paper is an attempt to explain this divergence from the earlier trend.*

At the outset, the paper dwells on the ambiguities surrounding the definition and the non-adherence of international norms in measuring the FDI inflows. The study finds that portfolio investors and round-tripping investments have been important contributors to India's reported FDI inflows thus blurring the distinction between direct and portfolio investors on one hand and foreign and domestic investors on the other. These investors were also the ones which have exploited the tax haven route most. These observations acquire added significance in the context of the substantial fall in the inflows seen during 2010-11.

*In most countries, particularly those that have faced chronic current account deficits, obtaining **stable long term FDI flows** was preferred over **volatile portfolio investments**. This distinction between long term FDI and the volatile portfolio investments has now been removed in the accepted official definition of FDI. From an analytical point of view, the blurring of the lines between long term FDI and the volatile portfolio investments has meant that the essential characteristics of FDI, especially the positive spill-overs that the long term FDI was seen to result in, are being overlooked. FDI that is dominated by financial investments, though a little more stable than the portfolio investments through the stock market, cannot deliver the perceived advantages of FDI. The net result is that while much of the FDI cannot enhance India's ability to earn foreign exchange through exports of goods and services and thus cover the current account gap on its own strength, large inflows of portfolio capital causes currency appreciation and erodes the competitiveness of domestic players. The falling share of manufacturing and even of IT and ITES means that there is less likelihood of FDI directly contributing*

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to export earnings. India seems to have been caught in a trap wherein large inflows are regularly required in order to finance the current account deficit. To keep FDI flowing in, the investment regime has to be liberalised further and M&As are allowed freely.

Even at the global level, the developmental impact of FDI is being given lesser importance notwithstanding the repeated assertions to the contrary in some fora. International data on FDI and its impact has never been unambiguous. If FDI has to deliver, it has to be defined precisely and chosen with care instead of treating it as generic capital flow. India should strengthen its information base that will allow a proper assessment of the impact that FDI can make on its development aspirations.]

1. Introduction

The perception of the role foreign direct investment (FDI) plays in the development process has evolved over time. Starting from the mid-sixties when the role of FDI in economic development was recognised and obstacles to the flow of FDI from industrialized to developing countries were sought to be removed there was a sharp change in the early 1970s when TNCs, the chief vehicles for FDI, were looked at suspiciously notwithstanding the recognised benefits. The dominant approach was to "monitor, restrict and regulate the activities of TNCs". Following the commercial bank debt crisis and the aid fatigue, in the 1980s, once again, countries became more interested in non-debt creating sources of external private finance.[1] Since then, more attention is being paid to the possible role of FDI in economic development. An extensive amount of literature on FDI has emerged regarding its role in not just augmenting domestic savings for investment but more as provider of technologies and managerial skills essential for a developing country to achieve rapid economic development. While many questions relating to the impact of TNCs on development have remained controversial, the focus now is more on how to maximize the positive effects of FDI.[2]

A concomitant form of capital flows to FDI is portfolio investment (FPI). Notwithstanding its attractiveness as non-debt creating nature, a facet seen to be positive because of the debt crises of the 'eighties, and its contribution to financial sector development, FPI, which is volatile in nature, is associated with problems specific to it. Steep appreciation in the currencies of recipient countries and the consequent adverse impact on the price competitiveness of domestic players and asset price bubbles have been associated with large influx of foreign portfolio capital flows. The loss of competitiveness diminishes the host country's ability to improve its current account on

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1 Yingqi Wei and V. N. Balasubramanyam, *Foreign Direct Investment: Six Country Case Studies*, Edward Elgar Publishing, 2004.

2 For a description of this and the role played by the UN, especially UNCTAD, in this process see: Torbjorn Fredriksson, "Forty years of UNCTAD research on FDI", *Transnational Corporations*, Volume 12, Number 3, December 2003, pp. 1-39. See also Marica Carcokovic and Ross Levine, "Does Foreign Direct Investment Accelerate Economic Growth?" in Theodore H. Moran, Edward M. Graham and Magnus Blomstrom (eds.), *Does Foreign Direct Investment Promote Development?*, Centre for Global Development, Washington, 2005, for a review of the literature on the impact of FDI on economic growth.

the strength of export of goods and services thus contributing to a situation of perpetual dependence. Managing the external sector has thus become a major issue by itself and attracted suggestions for imposing capital controls to moderate the flows. The recent global financial crisis has revived the need to place some restrictions on capital flows. Even the IMF, a staunch votary of capital account convertibility, has acknowledged that capital controls are a legitimate part of the toolkit to manage capital inflows in certain circumstances.[3] Thus, FDI is preferred over FPI because the former is seen to be stable and, being a bundle of assets in addition to capital, it could enable the host economy to gain competitiveness.

As global capital flows expanded manifold and into different sectors, India's approach towards FDI too changed ever since independence; the initial approach overwhelmingly reflecting hostility following the experience with the colonial rule. From being assigned the role of supplementing and strengthening the domestic private sector, FDI was given greater freedom and a role of its own to contribute to India's development process along with gradual liberalization of India's economic policies which started in the 1980s.[4] The New Industrial Policy, 1991, which accelerated the process of liberalisation, stated:

> While Government will continue to follow the policy of self-reliance, *there would be greater emphasis placed on building up our ability to pay for imports through our own foreign exchange earnings*. …
>
> *Foreign investment and technology collaboration will be welcomed to obtain higher technology, to increase exports and to expand the production base….*
>
> Foreign investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for promotion of exports. … The government will therefore welcome foreign investment which is in the interest of the country's *industrial development*.[5] (Emphasis added)

More recently, the *Economic Survey 2008-09* reiterated that:

> FDI is considered to be the most attractive type of capital flow for emerging economies as it is expected to bring *latest technology and enhance production capabilities* of the economy.[6] (Emphasis added)

And the National Manufacturing Competitiveness Council specified that:

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3 Jonathan D. Ostry, et. al., "Capital Inflows: The Role of Controls", IMF Staff Position Note, February 19, 2010, SPN/ 10/04. Last year, Brazil, Thailand and South Korea strengthened capital controls. See: Biswajit Dhar, "Uses and abuses of capital controls", *Mint*, October 26, 2010.

4 For a review, see Biswajit Dhar, "State Regulation of Foreign Private Capital in India", Corporate Studies Group Working Paper, 1988.

5 See: "Statement on Industrial Policy July 24, 1991" in Ministry of Commerce and Industry, *Handbook of Industrial Policy and Statistics*, 2001.

6 Ministry of Finance, *Economic Survey 2008-09*, para 133.

> Foreign investments mean both foreign portfolio investments and foreign direct investments (FDI). FDI brings better technology and management, access to marketing networks and offers competition, the latter helping Indian companies improve, quite apart from being good for consumers. This efficiency contribution of FDI is much more important.[7]

Starting from such basic premise, from a regime of selective approach to foreign investment with emphasis on transfer of high technology and promotion of exports, since the beginning of the 'nineties India has gradually expanded the scope for FDI by progressively increasing the number of eligible sectors as also the limits for FDI in an enterprise. The steps taken included removing the general ceiling of 40% on foreign equity under the *Foreign Exchange Regulation Act, 1973* (FERA), lifting of restrictions on the use of foreign brand names in the domestic market, removing restrictions on entry and expansion of foreign direct investment into consumer goods, abandoning the phased manufacturing programme (PMP), diluting the dividend balancing condition and export obligations, liberalising the terms for import of technology and royalty payments and permitting foreign investment up to 24% of equity of small scale units and reducing the corporate tax rates. FDI limit for small scale units was, however, dispensed with in 2009. The number of items reserved for the small scale sector has since been drastically pruned to just 20 thus virtually freeing the sector both from ownership criterion and product reservation.[8] The parallel process of virtual withdrawal of the Industrial Licensing System and the retreating from the primacy given to public sector also enhanced the scope for FDI participation in India.

Alongside opening up of the FDI regime, steps were taken to allow foreign portfolio investments into the Indian stock market through the mechanism of foreign institutional investors. The objective was not only to facilitate non-debt creating foreign capital inflows but also to develop the stock market in India, lower the cost of capital for Indian enterprises and indirectly improve corporate governance structures. On their part, large Indian companies have been allowed to raise capital directly from international capital markets through commercial borrowings and depository receipts having underlying Indian equity. Thus the country adopted a two-pronged strategy: one to attract FDI which is associated with multiple attendant benefits of technology, access to export markets, skills, management techniques, etc. and two to encourage portfolio capital flows which ease the financing constraints of Indian enterprises. FDI is also preferred as it is seen to be more stable than short term portfolio capital flows which have the tendency to be volatile and hence can cause financial instability—basic expectations from both types of capital have been different from each other.

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[7] India, National Manufacturing Competitiveness Council, *The National Strategy for Manufacturing*, 2006, pp. 23-24.

[8] See: http://www.dcmsme.gov.in/publications/reserveditems/reserved2010.pdf

As a result of the many steps that have been taken, India's FDI policy is now quite open and comparable to many countries.[9] Caps on FDI shares are now applicable to only a few sectors, mainly in the services sector.[10] Barring attempts at protecting Indian entrepreneurs with whom the foreign investors had already been associated with either as joint venture partners or technology licensors, it has been a case of progressive liberalisation of the FDI policy regime. Simultaneously, the government has continuously strived to remove the hurdles in the path of foreign investors both at the stage of entry and later in the process of establishing the venture, in order to maximize FDI inflows. Much of the foreign investment can now take advantage of the automatic approval route without seeking prior permission of the Central Government. While India did attract considerable amount of foreign portfolio investments, its record in FDI inflows for a long time was seen to be below its potential particularly when seen in comparison with the massive inflows reported by China. The progressive liberalization of the foreign investment policy as well as the steps to improve the investment climate could thus be seen as attempts to overcome this perceived failure to match initial expectations and also in comparison with China. More recently, however, additional scrutiny for security reasons[11] and for minimizing loss of revenue due to abuse of the double taxation avoidance agreements and round-tripping have been additional but restrictive features that are being referred to in respect of India's FDI policy regime.

In the overall, inflows of FDI have increased substantially compared to the earlier regime in which the scope for FDI was quite restricted. As a result, the stock of FDI in India jumped from $1.66 bn at the end of 1990, to $17.5 bn by the end of 2000 and further to a little above $164 bn by the end of 2009.[12] In the process, the FDI stock more than doubled between 2000 and 2004 and more than quadrupled between 2004 and 2009. The addition during 2004 and 2008 is quite spectacular as the stock increased by nearly $125 bn. Since 2000-01 an important change was introduced in the way FDI statistics are compiled which has made strict comparison of inflows overtime inapt. Though this did contribute

[9] See: Planning Commission, *Report of the Steering Group on Foreign Direct Investment*, August 2002, p. 22 and "Foreign Direct Investment in India: How Can it be Increased?" in IMF, *India: Selected Issues*, January 7, 2005, available at http://www.imf.org/external/pubs/ft/scr/2005/cr0587.pdf.

[10] These include air transport services, ground handling services, asset reconstruction companies, private sector banking, broadcasting, commodity exchanges, credit information companies, insurance, print media, telecommunications and satellites and defence production. Besides, FDI is not permitted in a few areas like agriculture (except floriculture, horticulture, development of seeds, animal husbandry, pisciculture, aquaculture and cultivation of vegetables and mushrooms) retail trading (except single brand product retailing), lottery, gambling and betting, chit fund, mutual benefit financial companies, trading in transferable development rights, real estate, manufacturing of cigars, cigarettes, tobacco or tobacco substitutes, atomic energy, and railway transport (other than mass rapid transport systems). See Consolidated FDI Policy (Effective from October 1, 2010) of the Department of Industrial Policy and Promotion (DIPP), Government of India, available at http://www.dipp.nic.in/FDI_Circular/FDI_Circular_02of2010.pdf.

[11] This issue was taken up by the National Security Council.

[12] UNCTAD, World Investment data.

to the observed increase in the reported FDI inflows there is no denying the fact of the sharp increase in the inflows especially during the last few years. There were hints that private equity might have been a major contributing factor to the enhanced inflows.[13] However, this question has not been examined in any detail.

This was the starting point of our enquiry into the nature of FDI inflows in the recent past. A preliminary examination of the individual inflow details did throw up the need to analyse the data more intently. Subsequently, a perusal of RBI's Master Circular on Foreign Investment in India and the Draft Press Note (DPN) on FDI Regulatory Framework issued in December 2009 made us further aware of the issues that could be associated with compilation of FDI inflows in India. The present exercise is thus primarily an attempt to examine the inflow data by going beyond the broad aggregates with a view to bring out the lesser explored characteristics of FDI in India and their developmental implications. This has necessarily led us to examine India's efforts to conform to international best practices on the one hand and to take a close look at some of the criteria adopted by international agencies themselves on the other. In the process, we also had an opportunity to look at the rationale and implications of the criteria proposed by the DPN and its follow up *viz.*, Consolidated FDI Policy (CFP) which became effective from April 1, 2010. In view of the difficulties faced in getting the relevant information, we are constrained to term the exercise as a *first approximation to the ground reality*. Notwithstanding this limitation, we do hope that the exercise succeeds in creating awareness among policy makers and researchers not only in India but also at the international level that there is a need to take a closer look at the present phenomenon of FDI.

The study covers the reported FDI inflows during September 2004 and December 2009. The choice of the period has been solely influenced by the availability of data on actual inflows by recipient companies incorporated in India, the disclosure of which was started in September 2004. Till then only approvals were being reported. Importantly, this covers the period which witnessed the sharpest increases in inflows. It may also be pointed out that the analysis provided in the paper would be helpful in understanding the sharp fall in FDI inflows during 2010-11 when the inflows for the first nine months have fallen almost by a quarter compared to the inflows during the corresponding period of the previous year.

2. Conceptual and Definitional Issues

Before embarking on a discussion of India's FDI inflows and their various characteristics it would be relevant and essential to describe what has come to be internationally recognized as FDI. This could provide a basis for categorising India's inflows. Here we

[13] See for instance: CP Chandrasekhar, Private Equity: A New Role for Finance?, *Economic and Political Weekly*, March 31, 2007, CP Chandrasekhar and Jayati Ghosh, "Private Equity and India's FDI Boom", *Business Line*, May 1, 2007; T T Ram Mohan , "Are FDI flows into India for real?", *Economic Times*, October 5, 2007 and "RBI confirms FDI data included PE inflows"Livemint.com, July 9 2007.

shall rely extensively on official documents and academic literature. According to the Benchmark Definition of OECD, the most referred to and relied upon definition of FDI:

> *Foreign direct investment* reflects the objective of establishing a lasting interest by a resident enterprise in one economy (*direct investor*) in an enterprise (*direct investment enterprise*) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship.
>
> ...Direct investment is not solely limited to equity investment but also relates to reinvested earnings and inter-company debt.[14]

It needs to be underlined that the key aspect of the above definition is *lasting interest* which is supposed to be evidenced by the fact of ownership of at least 10% voting power (because it is assumed to give the investor power to exercise significant influence over the investee). It should also be noted that apart from equity inflows there are other items to be considered for inclusion in the FDI statistics and there can be a variety of difficulties in measuring each of these. The crucial point, however, is that the first stage of identifying a direct investment enterprise is the ownership of 10% voting power and the rest basically follow from that. All investments below the 10% limit are considered as portfolio investments.

While this is the operational distinction between FDI and FPI, for a theoretical differentiation between the two one can refer to Dunning, who said:

> First, FDI involves the transfer of other resources than capital (technology, management, organizational and marketing skills, etc.) and it is the expected return on these, rather than on the capital *per se*, which prompts enterprises to become MNEs. Thus capital is simply a conduit for transfer of other resources than the raison d'être for direct investment. Second, in the case of direct investment, *resources are transferred internally within the firm* rather than externally between two independent parties: *de jure* control is still retained over their usage. ... *These are the essential differences between portfolio and direct investment*.[15] (emphasis added)

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14 Debt instruments include marketable securities such as bonds, debentures, commercial paper, promissory notes, non-participating preference shares and other tradable non-equity securities as well as loans, deposits, trade credit and other accounts payable/ receivable. All cross-border positions and transactions related to these instruments, between enterprises covered by an FDI relationship other than between related financial intermediaries are included in FDI.
See: OECD, *Benchmark Definition of Foreign Direct Investment*, Fourth Edition, 2008, pp. 48-49.

15 John H. Dunning, "Trade, location of economic activity and the multinational enterprise: a search for an eclectic approach", in John Dunning (ed.), *The Theory of Transnational Corporations*, UN Library on Transnational Corporations, Volume I, Routledge, 1993, p. 185. UNCTAD too made similar observations when comparing foreign portfolio and direct investments. See: UNCTAD, World Investment Report, 1997, Chapter III (Foreign Portfolio Equity Investment).

Long back, Hymer, in his seminal work, offered an explanation why portfolio investors seek control and made a distinction within FDI. He had classified direct investment into two types: Type 1 and Type 2.

> There are two main types of reasons why an investor will seek control. The first, which I shall call *direct investment,* Type 1, has to do with the prudent use of assets. The investor seeks control over the enterprise in order to ensure the safety of his investment. *This reason applies to domestic investment as well.*
>
> ...
>
> *The theory of Type 1 direct investment is very similar to the theory of portfolio investment.* The interest rate is the key factor in both. Direct investment of Type 1 will substitute for portfolio investment when the distrust of foreigners is high or when fear of expropriation and risks of exchange-rate changes are high, but its movements will still be in response to differences in the interest rate.
>
> ...
>
> There is another type of direct investment that does not depend on the interest rate and which I shall call direct investment of Type 2, or *international operations.* In this second type of direct investment, the motivation for controlling the foreign enterprise is not the prudent use of assets but something quite different. The control of the foreign enterprise is desired in order to remove competition between that foreign enterprise and enterprises in other countries. Or the control is desired in order to appropriate fully the returns on certain skills and abilities.[16]

It can be seen from the above that but for the control aspect Type 1 direct investment is nothing but portfolio investment.[17] Buckley and Brooke's characterisation that FDI "... represents a packaged transfer of capital, technology, management and other skills, *which takes place internally within the multinational firms*" (emphasis added) is similar to Dunning's description of FDI and Hymer's elaboration of Type 2 direct investment.[18]

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16 Stephen Hymer, "On multinational corporations and foreign direct investment", in John Dunning (ed.), *The Theory of Transnational Corporations*, UN Library on Transnational Corporations, Volume I, Routledge, 1993, p. 25.

17 Interestingly, the European Commission also in its submission to the WTO categorically stated that:

> Portfolio investors, as a general rule do not expect to obtain additional benefits derived from the management control of the enterprise in which they invest. Their main concern is the appreciation of the value of their capital and the return that it can generate regardless of any long-term relationship consideration or control of the enterprise. This is the main rationale behind portfolio investment, that makes it substantially different from FDI.

The Commission, however, mentioned that

> "… if any of those instruments complies with the criteria of FDI capital transactions they are considered part of FDI".

See: "Concept Paper on the Definition of Investment" WT/WGTI/W/115, 16 April 2002, available at http://trade.ec.europa.eu/doclib/docs/2004/july/tradoc_111123.pdf

18 Peter J. Buckley and Michael Z. Brooke, *International Business Studies : An Overview*, Blackwell Publishers, Oxford, 1992, p. 249.

This distinction between FDI and FPI is extremely relevant in the present context because of the changing sectoral composition of the reported global FDI flows and nature of foreign investors. A good part of global FDI flows are accounted for by private equity funds (PE), hedge funds (HF) and sovereign wealth funds (SWF); the former two falling under the category of collective investment funds/institutions.[19] UNCTAD in its *World Investment Report* 2010 noted that FDI by private equity funds and sovereign wealth funds together accounted for over one-tenth of global FDI flows in 2009: up from less than 7 per cent in 2000 but down from 22 per cent in the peak year of 2007.[20] PE funds are also major contributors to cross-border M&As which in turn are a major form of the global FDI phenomenon. (Table 1)

Table 1
Cross-border M&As by Private Equity firms, 2000–2010

Year	*Number of Deals*		*Value*	
	Number	*Share in Total (%)*	*$ billion*	*Share in Total (%)*
2000	1,338	13	92	7
2001	1,246	15	88	12
2002	1,244	19	85	18
2003	1,486	22	108	27
2004	1,622	22	157	28
2005	1,725	19	205	22
2006	1,688	18	267	24
2007	1,906	18	456	27
2008	1,776	18	303	24
2009	1,987	24	106	19
2010*	696	22	38	16

Source: UNCTAD, *World Investment Report 2010*, Table I.4.
* For 2010, January–May only.
Note: Includes M&As by hedge funds. Private equity firms and hedge funds refer to acquirers as "investors not elsewhere classified". This classification is based on the Thomson Finance database on M&As.

While there is a strong theoretical difference between FDI and FPI, it is evident that the importance given to control and the 10% cut-off point required the categorisation of portfolio investments into direct investments. The forced classification of private equity investments as FDI becomes further evident from the *World Investment Report*, which while acknowledging the phenomenon of collective investment funds becoming the 'growing sources of FDI', stated that:

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[19] According to OECD, collective investment institutions include Investment funds, Mutual funds, Unit trusts, Variable capital companies, Investment limited partnerships, Feeder/master funds, umbrella funds/sub-funds, funds of funds, Hedge funds, Professional investor funds, Private equity funds, Distressed funds, Property and real estate funds, and Money market funds. See: OECD, *Benchmark Definition of Foreign Direct Investment*, 4th Edition, p. 193.

[20] UNCTAD, *World Investment Report*, 2010, p. xviii.

> As long as cross-border investments of private equity and hedge funds exceed the 10% equity threshold of the acquired firm, these investments are classified and should be recorded as FDI, even if a majority of such investments are short term and are closer in nature to portfolio investments. Investments by these funds *may be the latest examples of portfolio investment turning into FDI.*[21] (emphasis added)

Just a little earlier UNCTAD had said:

> Cross-border investments of private equity funds that lead to an ownership of 10% or more are in most cases recorded as FDI *even if private equity funds do not always have the motivation for a lasting interest or a long-term relationship with the acquired enterprise.*[22] (emphasis added)

It, however, cautioned that:

> FDI by collective investment funds is a new form of foreign investment, which raises a number of questions that deserve further research. For instance, how does FDI financed by private equity funds differ from FDI by TNCs in its strategic motivations? Who controls such funds? And what are their impacts on host economies?[23]

OECD too echoed this when it said:

> Both aspects, investments in CIIs (collective investment institutions) and by CIIs, are included in FDI statistics as far as the basic FDI criteria are met. However, the nature and motivation of CIIs may differ from those of MNEs and there is a need to observe this phenomenon more closely in the coming years.[24]

OECD in its benchmark definition (4th Edition) clarified that investments by CIIs which were till then being classified as portfolio investments due to lack of clarity in international standards should be included in FDI statistics as long as they meet the FDI criteria. Interestingly, OECD also said that

> CIIs are generally "brass plate" enterprises and are managed by professional investors who may offer a variety of funds with their own market orientation and who make investment decisions on behalf of investors. Administration, management, custodial and trustee services may be provided to the CIIs by separate service providers,...[25]

Private equity (including venture capital) certainly has a shorter investment horizon unlike the traditional FDI which would not start off with a pre-conceived idea of exiting an enterprise.[26] Private equity investors have the overriding objective of large and fast

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21 UNCTAD, *World Investment Report*, 2006, p. 16.
22 UNCTAD, *World Investment Report*, 2005, p. 37, n31.
23 UNCTAD, *World Investment Report*, 2006, p. 21.
24 OECD, *Benchmark Definition of Foreign Direct Investment*, 4th Edition, 2008, p. 23.
25 *ibid.*, pp. 192-193
26 In sharp contrast to FDI is the behaviour of private equity.
Private equity professionals have their eye on the exit from the moment they first see a business plan. ... If a

contd…

capital gains and revenue in other forms and there is no question/intention of integrating the investee company into their own structures like an MNC does.[27] By their very character, these are *not long term* investors. Also, in their operations one cannot distinguish between domestic and foreign. They do not fall under any of the motives of FDI namely, resource seeking, efficiency seeking, market seeking or strategic asset seeking. If their investments have to be treated as FDI, they may be categorised as pure 'return seeking' FDI.

2.1 10% Threshold and Significant Influence vs. Control

Keeping the issue of classification of private equity and other collective investments *per se* aside for the time being, there is a need to have a close look at the crucial 10% threshold itself. Indeed, one of the tasks assigned to the Direct Investment Technical Expert Group (DITEG), a joint IMF/OECD expert group, was to examine whether it could be raised to 20%. The DITEG recommended the increase in the threshold to 20% in the following manner.

> The group endorsed the proposal to move to 20 per cent of voting power or ordinary shares as the threshold for the operational definition for a direct investment relationship, even though it was recognised that changing the current threshold of 10 per cent to 20 per cent would not have a significant impact on the data. *The group found that there were no strong conceptual grounds for choosing 10 or 20 per cent, and so any choice below 50 per cent would be arbitrary.* However, there are strong practical arguments for supporting the change to 20 per cent threshold, namely with regard to accounting standards. International Accounting Standards (IAS) as well as the accounting standard used by the United States utilize a 20 per cent threshold for financial statements.[28] (emphasis added)

This recommendation was, however, rejected by the OECD Workshop on International Investment Statistics which decided to:

> (i) to maintain the current 10 per cent threshold, thus not endorsing the recommendation of DITEG to change the threshold to 20 per cent;
>
> (ii) to maintain the strict application of the 10 per cent threshold with a view to *achieving cross-country comparability of FDI statistics*,...[29] (emphasis added)

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fund manager can't see an obvious exit route in a potential investment, then it won't touch it. See: http://www.altassets.com/private-equity-glossary.html

27 It is indeed said that: "Ultimately, of course, the private equity business is all about achieving financial returns. Some firms may have aspirations to add value and growth, but that is a means to an end—the goal is to make money." See: "Private Equity in India: An Executive Round Table" at http://content.spencerstuart.com/sswebsite/pdf/lib/PrivateEquityIndia_2007_web2.pdf

28 Direct Investment Technical Expert Group (DITEG) Outcome Paper # 2 (Revised version), September 24, 2004. The DITEG was created in 2004 as a joint IMF/OECD expert group to make recommendations on the methodology of direct investment statistics for the revision of the *BPM5* and the *Benchmark Definition.*

29 Draft Summary of the Meeting of the OECD Workshop on International Investment Statistics (October 12-13

contd…

While it is repeatedly emphasized that investors could exercise significant influence even with less than 10% share in equity and that there can be situations where even a higher share in equity need not be accompanied by control, yet a strict adherence to the 10% criterion is advocated for the sake of uniformity at the international level. The OECD's position in this regard is that:

> Some compilers may argue that in some cases an ownership of as little as 10% of the voting power may not lead to the exercise of any significant influence while on the other hand, an investor may own less than 10% but have an effective voice in the management. Nevertheless, the recommended methodology does *not allow any qualification of the 10% threshold* and recommends its *strict application to ensure statistical consistency across countries*. (emphasis added).[30]

It is thus evident that there is no absoluteness to the 10% level and the criterion has remained unchanged in the most recent exercise on the definition mainly in order to ensure international comparability. On the other hand, the assumption that raising the threshold would not have much impact on the FDI data is something that needs to be looked closely into especially when the nature of foreign investors has got diversified. In this context, the assertion of IMF Balance of Payment Manual (5th Edition) needs special mention.

> Most direct investment enterprises are either *(i)* branches or *(ii)* subsidiaries that are wholly or majority owned by non-residents or in which a clear majority of the voting stock is held by a single direct investor or group. The borderline cases are thus likely to form a rather small proportion of the universe.[31]

It is, however, more likely that the lower limit of 10% for ascertaining influence coupled with non-exclusion of investments by collective investment schemes for consideration as FDI would have resulted in the estimated FDI flows being far larger than otherwise especially in the context of the global capital flows changing their character and collective investment funds playing a major role. A foreign investor when investing in another enterprise in the same line of activity, whether domestic or foreign, would seek to have control because of the involvement of many factors. While the general preference could be a wholly-owned entity, circumstances like the necessity to enter into joint ventures and host country regulations may require the foreign investor to settle for a lower share. In each of these situations control on the one hand and directly relevant contribution to

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2004), prepared by the OECD.

30 OECD, *Benchmark Definition of Foreign Direct Investment*, Fourth Edition, 2008, p. 49. Interestingly, the *New Palgrave Dictionary of Economics* does not use the term significant influence. It terms 10% as implying controlling interest when it says:

> Foreign direct investment (FDI) occurs when an individual or firm acquires controlling interest (typically defined as at least ten per cent ownership) in productive assets in another country.

Bruce A. Blonigen, "Foreign Direct Investment", in Steven N. Durlauf and Lawrence E. Blume (eds.), *The New Palgrave Dictionary of Economics*, Second Edition, 2008, pp. 459-462.

31 IMF Balance of Payments Manual, 5th Edition, p. 87.

the enterprise's operation by the foreign investor on the other, are logical to expect. Going by Hymer's direct investment of Type 2, control would be necessary so as to prevent competition. In case of joint ventures it has been indeed said:

> Even if a foreign entity cannot own a majority of a joint venture, it may be able to legally obtain operational control through other means. One may surround the joint venture with contractual obligations to the foreign venturer. For example, if the joint venture is to assemble components manufactured in the United States, the U.S. *investor retains significant control over the joint venture regardless of how many shares the investor owns or how many directors it can name to the board* because it controls the supply of components. Similarly, a U.S. investor can exercise control through supply contracts, marketing agreements, management contracts, *and veto power in the joint venture agreements*. (emphasis added)[32]

Another relevant aspect is that the widely adopted OECD definition is based on the assumption of significant influence. Interestingly, a distinction was made by Lipsey by referring to United Nations System of National Accounts (SNA) wherein he said:

> What constitutes a foreign direct investment entity has been defined differently for balance of payments purposes and for studies of firm behavior.
>
> The dominant current definition of a direct investment entity, prescribed for balance-of-payments compilations by the International Monetary Fund (IMF) (1993), and endorsed by the OECD (1996), avoids the notion of control by the investor in favor of a much vaguer concept (long term interest and significant influence).
>
> The IMF definition is governing for balance-of-payments compilations, but there is a different, but related, concept and a different official definition in the United Nations System of National Accounts, ... that retains the idea of control, and reflects the micro view more. In these accounts, which measure production, consumption, and investment, rather than the details of capital flows, there is a definition of "foreign-controlled resident corporations." Foreign-controlled enterprises include subsidiaries more than 50 percent owned by a foreign parent. "Associates" of which foreign ownership of equity is 10–50 percent, "*may be included or excluded by individual countries according to their qualitative assessment of foreign control…*" (Inter-Secretariat Working Group on National Accounts, 1993, pp. 340–1). Thus, from the viewpoint of a host country, and for analyzing production, trade, and employment, control remains the preferred concept.[33] (emphasis added)

IMF also made this point clear when it said:

> The concept described in this *Manual* is broader than the *SNA* concept of foreign-controlled, ..., resident enterprises. In the *SNA,* that distinction ... is made in the

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[32] Schaffer Richard, Beverley Earle and Filiberto Agusti (1999), *International Business Law and Its Environment*, 4th Edition, West Educational Publishing Co, Cincinnati, p. 581.

[33] Robert E Lipsey, "Foreign Direct Investment and the Operations of Multinational Firms: Concepts, History, and Data", in E. Kwan Choi and James Harrigan (ed.), *Handbook of International trade*, Blackwell, 2003, pp. 287-319.

compilation of various accounts because of the distinction's potential analytic usefulness in the examination of differences (characteristics such as value added, investment, employment, etc.) between enterprise subsectors. Thus, linkage of the direct investment component of the *financial account* with the foreign-controlled sector is by no means a complete one, primarily because the two serve different purposes. As presented in this *Manual*, the primary distinguishing feature of *direct investment* is the significant influence that gives the investor an effective voice in management. For the foreign-controlled sector, the primary distinguishing feature is control.[34]

Thus for economic analysis of foreign investment one needs to focus more on control and look into the circumstances of investment rather than any specific percentage. In fact, the European Commission (EC) suggested that to ascertain a direct investment relationship when the foreign investor holds less than 10% of the equity, the following criteria could be taken into account to determine whether a direct investment relationship exists:

a) representation in the Board of Directors;
b) participation in policymaking processes;
c) inter-company transactions;
d) interchange of managerial personnel;
e) provision of technical information; and
f) provision of long-term loans at lower than existing market rates.[35]

On the other hand, the EC also emphasised the need to go beyond the standard definition and taking into account the national legal provisions as also circumstances.

Situations vary very much from country to country and depend on the legal framework for corporate governance, i.e. the legislation regulating the allocation of property rights and control of enterprises. ... Precise allocation of control between national and foreign entities requires compilers of statistics not just to apply the definition but also to make a supplementary assessment.[36]

Since, voting power of more than 10% also does not always ensure control, it is logical that one needs to follow a case-by-case approach in such cases too.

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34 IMF, *Balance of Payments Manual*, 1993.

35 Supra note 17.

36 See: Eurostat, European Commission, *Foreign Affiliates Statistics (FATS) Recommendations Manual*, Eurostat's Methodologies & Working Papers, 2009 Edition, p. 14. Available at http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-AR-09-014/EN/KS-AR-09-014-EN.PDF. A description of legal provisions in India and how in practice the general perceptions can be defeated has been described in K.S. Chalapati Rao and Biswajit Dhar, "Operation of FDI Caps in India and Corporate Control Mechanisms", ISID Working paper WP2010/11 available at http://isid.org.in/pdf/WP1011.PDF.

2.2 Need for Case-by-Case Approach

2.2.1 Tata Motors Ltd

The necessity for a case by case approach may be better understood from a few practical examples. The classification could become extremely important when leading companies of an economy/sector are involved. For instance, Tata Motors Ltd (earlier Tata Engineering & Locomotive Co Ltd), India's leading truck manufacturer, entered into collaboration with Daimler Benz way back in 1954 for manufacturing commercial vehicles. The collaboration ended in 1969. Since then the vehicles are being called Tata Trucks instead of Tata Mercedes-Benz Trucks. But the foreign investor did not completely withdraw its investment in the equity capital of Tata Motors. Its nominee also continued to be on the board of Tata Motors. In 1986 the company started producing light commercial vehicles. In 1991 Tata Sierra SUV and later in 1992 Tata Estate MUV were launched. Tata Motors entered into a separate 49:51 JV with Daimler-Chrysler in 1994 for manufacture of Mercedes-Benz cars in the country. This alliance ended in 2001. In 1998 Tata Safari and Indica passenger cars were launched. In 2007, Tata Motors had given a no objection to the German firm's plans to set up its independent commercial vehicles business in the country. From the beginning the German investor had more than 10% equity. From the time we could get the shareholding details, i.e., since 2001 and until December 2009, there had been no change in the number of shares held by Daimler. However, due to the expansion of Tata motor's equity, the share of Daimler came down from 10% in December 2001 to 5.34% in December 2009. (Table 2) Subsequently, Daimler sold off its entire equity. On the day when the announcement came, the stock market did not react adversely to the news indicating that the divestment would not have any adverse impact on Tata Motors' working. In fact, there was a marginal increase in the company's share price on that day. Earlier Daimler's representative on the company's board did not seek re-election in the AGM held in July 2006.

Table 2
Daimler Chrysler Investment in Tata Motors

End of	*No. of Shares*	*% Share in Total*
December 2001	2,55,96,476	10.00
December 2002	2,55,96,476	8.00
December 2003	2,55,96,476	7.75
December 2004	2,55,96,476	7.08
December 2005	2,55,96,476	6.80
December 2006	2,55,96,476	6.64
December 2007	2,55,96,476	6.64
December 2008	2,55,96,476	5.69
December 2009	2,55,96,476	5.34
March 2010	sold off	0.00

Source: Shareholding pattern of the company reported by the Bombay Stock Exchange website.

In the prospectus issued in 1980, the company did not mention any special relationship with Daimler. It merely stated:

> As regards Daimler–Benz AG their present holding in the company is approximately 13% of the subscribed equity capital. It is in the long term interest of the Company that Daimler-Benz AG, who are world leaders in the field of automobile manufacture, maintain their equity percentage.[37]

Given this background, it would be important whether Tata Motors can be classified as an FDI company and if so till what period. For us it looks appropriate, notwithstanding the continued equity participation by Daimler of at least 10% thereafter and representation on the board, to treat it as an FDI company only till 1969 when the technical collaboration ceased. There is no evidence to show that the subsequent developments at Tata Motors were in any way directly contributed by Daimler.

2.2.2 Ballarpur Industries Ltd (BILT)

Another relevant case is that of Ballarpur Industries Ltd (BILT), a well-diversified leading paper manufacturing company in India. With no track record of substantial foreign equity earlier, in 1998, the company received government's permission to give 16.7% stake to Al-Murjan Trading & Industrial Co Ltd of Saudi Arabia. This was the time when the Thapar group was undergoing restructuring and required funds. Agreement with Al-Murjan involved induction of their nominee on BILT's board. The foreign investor exited BILT in March 2005 and withdrew its nominee. (Table 3) A senior official of the company said in this context that "(T)hey sold their equity stake in the market as they are mainly a trading company and want to exit from non-core business". It is evident that Al-Murjan was only a financial investor and it could not have brought with it any additionality into the functioning of BILT. From this perspective, one can assume that BILT was not an FDI company even when Al-Murjan had more than 10% equity in it.[38]

Table 3
Foreign 'Promoter' of Ballarpur Industries Ltd

End of	*Name of the Foreign Investor*	*No. Of Shares*	*% Share in Total*
March 2001	Al-Murjan Trading & Industrial Co Ltd #	1,00,00,000	13.98
March 2002	Foreign Company	1,18,08,882	16.51
March 2003	Al Murjan Trading & Industrial Co Ltd #	1,00,00,000	7.78
Mar 2004	Foreign Companies	1,30,48,882	8.03
December 2004	Foreign Companies	1,11,98,882	6.89
Mar 2005	Sold off the entire shareholding	0	0.00

Source: Shareholding pattern of the company reported by the Bombay Stock Exchange website.
Shown among the promoters.

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37 Tata Engineering & Locomotive Co. Ltd, *Prospectus* dated14th August 1980.
38 "Al-Murjan Exits Bilt", http://www.financialexpress.com/news/almurjan-exits-bilt/105100/0

2.2.3 VST Tillers Tractors (VST)

The company, market leader in tillers, was started in 1967 as a joint venture and technical collaboration with Mitsubishi Heavy Industries and Mitsubishi Corporation, Japan for the manufacture of Power Tillers and Diesel Engines. In 1984, an additional technical and financial collaboration was entered into with Mitsubishi Agricultural Machinery Company Ltd, Japan for the manufacture of 18.5 HP, 4 wheel drive Tractor. According to the earliest available shareholding pattern of the company (June 2002), the foreign collaborators had 3.78% equity shareholding. Subsequently, this shareholding was shown against foreign promoters, Mitsubishi Heavy Industry Pvt Ltd being one of them. The company's annual report also acknowledged the joint venture partners, Mitsubishi Heavy Industries Ltd and Mitsubishi Machinery Co Ltd, Japan till 2003-04. It is only in 2006-07 when the company promoted MHI-VST Diesel Engines Pvt Ltd as a joint venture with the Mitsubishi group that the representation on the company's board was reduced from two to one.

It is pertinent to note that the Articles of Association of VST specifically state that:

> The regulation for the management of the Company and for the observance of the members thereof and their representatives shall be such as are contained in these Articles. The Company shall adopt and carry into effect the Joint Venture agreement dated 10th November 1966 entered into by the Promoters with the Joint Venture partners M/s. Mitsubishi Heavy Industries Ltd. and Mitsubishi Corporation (formerly known as Mitsubishi Shoji Kaisha Ltd, Japan). The aforesaid agreement shall form a part of these articles of association for all intents and purposes and particularly the provisions contained therein relating to transfer of shares and pre-emptive rights of the parties thereto, to acquire the shares.
>
> …
>
> The joint venture partners M/s. Mitsubishi Heavy Industries Limited, M/s. Mitsubishi Corporation and M/s. Mitsubishi Agricultural Machinery Company Limited, Japan shall be collectively entitled to appoint one Director mentioned in clause (a) above, and shall be entitled to remove him from that office and to appoint any other person thereto from time to time.[39]

In the circumstances, the company may be treated as an FDI company in spite of such a low share of the foreign partners.

The above examples underline the need for case-by-case approach for ascertaining control. In this context, it may also be relevant to refer to the Securities and Exchange Board of India (SEBI) Takeover Regulations Advisory Committee which noted that

> ... given the case-specific nature of "control" as a concept, the Committee decided to refrain from stipulating whether the power to say "no" would constitute "control"

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[39] Memorandum and Articles of Association of VST Tillers Tractors Ltd filed on November 10, 2009 with the MCA.

> for purposes of the Takeover Regulations. Whether a person has acquired control by virtue of affirmative rights would therefore have to be discerned from the facts and circumstances surrounding each case.[40]

2.3 Round-Tripping

Another important aspect of the global capital flows is the phenomenon of round-tripping which acquired prominence in the context of huge FDI inflows to China.[41] The OECD was of the view that

> Round-tripping refers to the channelling abroad by direct investors of local funds and the subsequent return of these funds to the local economy in the form of direct investment.[42]

In general, OCED categorised direct investment enterprise to be of the round-tripping type if its ultimate investor belongs to the same economy.[43] Again, OECD noted that, in practice, all transactions/positions between fellow enterprises relate to the funds circulating within multinational groups via shared service centres or to take advantage of the best financing opportunities and that "(T)hey may also represent round-tripping of capital".[44] While China's round-tripping FDI is often discussed, in fact, because of flow of investments among group companies, even FDI into the USA has an element of round-tripping.[45]

OECD identifies the main incentives for round-tripping as: *(i)* tax and fiscal advantages; *(ii)* property right protection; *(iii)* expectations on exchange control and exchange rate and; *(iv)* access to better financial service. Regarding the last one, it explains that financial markets of some economies not being well developed, enterprises resident in these economies have to access overseas financial markets for better financial services, such as listing of companies in overseas stock markets. The funds raised will be brought back to host economies in the form of FDI. Round-tripping may occur as a part of this process. In order to give an idea of the genuine magnitude FDI, the *Benchmark Definition* recommended separate supplementary breakdowns when this phenomenon affected significantly FDI data of a country.[46]

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40 Securities and Exchange Board of India, *Report of the Takeover Regulations Advisory Committee,* July 19, 2010, p. 29. (Chairman: C. Achutan)

41 See for example: Nirupam Bajpai and Nandita Dasgupta , "What Constitutes Foreign Direct Investment? Comparison of India and China", CGSD Working Paper No. 1, January 2004, Working Papers Series, Center on Globalization and Sustainable Development, The Earth Institute at Columbia University. Also see: Geng Xiao, "People's Republic of China's Round-Tripping FDI: Scale, Causes and Implications", July 2004 available at www.hiebs.hku.hk/working_paper_updates/pdf/wp1137.pdf.

42 OECD, *Benchmark Definition of Foreign Direct Investment,: Fourth Edition*, 2008, p. 158.

43 *ibid.*, pp. 159-160.

44 *ibid.*, p. 24.

45 *ibid.*, pp. 212-213.

46 *ibid.*, p. 159.

Round-tripping is important not only from the point of view of overstating of capital flows. As the OECD pointed out, some domestic companies may raise finances abroad and bring the same back into the national economy. In this case, though it would not amount to overstatement of capital flows, the flows do not carry with them the additional attributes of technology, management skills, marketing network, etc. Thus the receiving enterprises would be like domestic enterprises irrespective of the level of 'foreign held equity'.

2.4 Indian Practice

From the above, it is evident that the choice of 10% for determining FDI relationship has been more of a convenient thumb rule and that it has been mandated in order to maintain international comparability. In India, for a long time, foreign direct investments were associated with 'control and direction of the enterprise by foreign investors'. Branches of foreign companies were the obvious cases to fall under this category. In addition, Indian joint stock companies were also regarded as controlled from abroad if either of the following two conditions were met:

(a) the foreign ownership was sufficiently large to bestow control over the affairs of the company and/or

(b) there was an association or an agreement with the foreign owners by virtue of which control is vested (directly or indirectly) in them.[47]

For operational purposes, besides Indian subsidiaries of foreign companies, *(i)* companies in which non-residents belonging to *one country* owned 40 per cent or more of the ordinary shares, *(ii)* companies managed by foreign-controlled managing agents in terms of a managing agency agreement and *(iii)* other companies 25% or more of whose ordinary shares were owned by another foreign-controlled company in India were treated as controlled from abroad. Interestingly, portfolio investments comprised ordinary shares held by non-residents, other than those treated as foreign controlled, as well as preference shares and debentures held by all non-residents, *irrespective of whether they exercised control or not*.

For studies on finances of foreign controlled rupee companies (FCRCs) RBI essentially followed the above basic approach with some modification possibly because the Managing Agency system was abolished in 1969. FCRCs were defined as:

> Indian joint stock Companies which were subsidiaries of foreign companies, companies in which 40 per cent or more of the equity capital was held outside India in any one country and companies in which 25 per cent or more of the equity capital was held by a foreign company or its nominee were treated as Foreign-Controlled Rupee Companies (FCRCs). [48]

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47 RBI, *Report on the Survey of India's Foreign Liabilities and Assets as on 31st December 1955*, 1957, p. 10.

48 RBI, "Finances of Foreign Direct Investment Companies, 1993-94", *RBI Monthly Bulletin*, March 1999, p. 245.

However, following the Balance of Payments Manual (5th edition), RBI adopted the FDI company concept and explained:

> A direct investment enterprise is defined as an incorporated or unincorporated enterprise in which a direct investor, who is resident in another economy, owns 10% or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated). As such, a company in which 10 per cent or more equity capital is held by a *single non-resident investor* is defined as a Foreign Direct Investment Company. (emphasis added)[49]

The emphasis has been more on bringing India's FDI reporting system in alignment with the international reporting system. This was further operationalised following the recommendations of the RBI Committee on Compilation of Foreign Direct Investment in India in 2002. In this process, the 10% criterion has been taken as inviolable and the finer aspects of FDI have been ignored. In particular, the representative character of company finance studies based on the new criteria compared to those based on FCRCs to reflect the operations of FDI in India were also not discussed. The fact of unquestioned allegiance to the 10% criterion ignoring the context surrounding the investment is reflected at many places. For instance, the Economic Advisory Council to the Prime Minister in its Review of the Economy 2007-08 said:

> Inflows of Private Equity (PE) investments have also been quite large. Since in most cases PE flows constitute less than 10% of the capital of the company being invested they should ideally be reported under Portfolio Capital, and not under FDI. *It is not clear what the current accounting practice is.* (emphasis added)

Implied in this statement is the EAC's belief that in India FDI is measured strictly according to the minimum 10% shareholding criterion. It is also evident that but for the insistence on the 10% criterion, foreign private equity would have been classified as portfolio capital rather than as FDI. Also reflected in the above is the fact that an important official advisory body was unaware of certain aspects of computing FDI in India.

The thin line between FDI and foreign portfolio investments (by FIIs) as far as classification of foreign private equity and venture capital in India is further evident from the following observation of the Working Group on Foreign Investment set up by the Ministry of Finance.

> **Inflows into unlisted equity**: At a conceptual level, a private equity or venture capital fund outside India can invest in India in three ways. *First*, private investment in unlisted equity can take place if the foreign entity creates an investment vehicle which obtains an FII registration. *Second*, even without registering as an FII a private equity or venture capital fund outside India can invest in an Indian unlisted company up to the level of caps for FIIs. These investments would be treated as FDI, ... These two mechanisms, put together, characterize the main avenues for private

[49] *ibid*.

> equity/venture capital inflows into India. The *third* way for private equity or venture capital funds outside India to invest in the country is to register as an FVCI with SEBI and be regulated as such.[50] (emphasis added)

The Consolidated FDI Policy (CFP) issued by the Department of Industrial Policy and Promotion (DIPP) on March 31, 2010 and its predecessor Draft Press Note (DPN) on FDI Regulatory Framework throw light on the way FDI is being measured in India. While reiterating the motivation of the direct investor as:

> ... a strategic long term relationship with the direct investment enterprise to ensure the significant degree of influence by the direct investor in the management of the direct investment enterprise.

the CFP further explained:

> Investment in Indian companies can be made both by non-resident as well as resident Indian entities. *Any non-resident investment in an Indian company is direct foreign investment.*[51] (emphasis added)

Interestingly, the DPN issued earlier for discussion by the Government, stated that:

> In India the 'lasting interest' is not evinced by any minimum holding of percentage of equity capital/shares/voting rights in the investment enterprise.[52]

This suggests that all foreign investments (other than those purchased by FIIs on the stock market) in equity capital and equity related instruments are being treated as FDI *irrespective of the extent of foreign share*. It is obvious that in not all the cases there will be lasting interest and the ability or intention to significantly influence the management of the investee company. While this contrasts sharply with the 'international best practice', one cannot expect such FDI to be accompanied by the attendant attributes and deliver the perceived benefits from FDI. Dunning's OLI paradigm suggests that the foreign investor should have certain advantages over the domestic enterprises in order to compensate for the disadvantages associated with operating in an alien environment. Pure financial investments are less likely to be accompanied by such ownership advantages which the foreign investor would like to internalise.

In the backdrop of the internationally adopted criterion not being followed in practice, one may not expect round-tripping by domestic investors to be treated separately as a distinct category of capital flow other than FDI. In spite of the fact that some well-known companies which raised money by listing abroad have invested back in India and occasional reports in the press regarding some delayed or disapproved FDI proposals because of suspected round-

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50 See: Ministry of Finance, *Report of the Working Group on Foreign Investment*, 30 July 2010, p. 71. (Chairman: U.K. Sinha)

51 Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Consolidated FDI Policy (Effective from April 1, 2010) available at http://siadipp.nic.in/policy/fdi_circular/fdi_circular_1_2010.pdf.

52 Draft Press Note: "Regulatory Framework of FDI", issued in December 2009 by the DIPP.

tripping of funds, this phenomenon has never been explored fully in case of India.[53] A news report of 2003 attributed to RBI did, however, say that round-tripped FDI as a part of the total FDI was insignificant and could be as low as 2–3%.[54]

Interestingly, Bain & Co., a major global business and strategy consulting firm, says:

> Employing another tactic, some domestic PE funds invest in Indian companies through wholly owned offshore subsidiaries. Because several jurisdictions, including Singapore and Mauritius, have double-taxed treaties with India, PE funds can use Special Purpose Vehicles based there to avoid transferability restrictions when they eventually exit from an investment.[55]

From the foregoing it is evident that besides the usual classification of market seeking, efficiency seeking, resource/strategic asset seeking FDI there are also categories that could be called return seeking and round tripping FDI. The last two, strictly speaking, cannot be equated with FDI. Thus there is a case for analysing the reported FDI inflows, keeping the expectations from FDI, by suitably classifying the foreign investors. We shall, in the following, try to analyse India's FDI inflows from this perspective.

3. Analysis of Inflows

3.1 The Aggregates

As noted above, the reported stock of FDI in India increased substantially after opening up of the economy. Table 4 presents the inflows data for the 10-year period 2000-01 to 2009-10 which does not suffer from comparison problems.[56] The change in the reporting practice which introduced new items, especially reinvested earnings of the already established ones, did contribute significantly to the reported higher total inflows: 44.21% during 2000-01 -- 2005-06 and 30.63% during 2005-06 -- 2009-10. There is, however, no denying the fact of a dramatic rise in the inflows after 2005-06 as the reported equity inflows which fluctuated between 2001-02 and 2004-05, managed to climb slowly initially and rapidly after 2005-06. The FDI Equity inflows during the five years 2005-06 to 2009-10 were almost seven times those of the previous five years 2000-01 to 2004-05. (Chart 1)

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53 *Wenhui* Wei, "China and India: Any difference in their FDI performances?"*Journal of Asian Economics*, 16 2005, pp. 719–736.

54 http://www.rediff.com/money/2003/apr/12fdi.htm

55 Bain & Company, *India Private Equity Report 2010* available at http://www.bain.com/bainweb/PDFs/cms/Public/India_Private_Equity_Report.pdf

56 India adopted the international practice of reporting FDI inflows data and started giving out the information for the year 2000-01 onwards. Till then reinvested earnings and other capital provided by foreign direct investors were not being reported as part of the inflows data. Thus the reported inflow figures have better comparability from 2000-01 onwards and the earlier figures suffer from a degree of underestimation. This was introduced following the recommendations of the RBI Committee on Compilation of Foreign Direct Investment in India, October 2002.

Table 4
Reported FDI Inflows into India and their Main Components
(As per International Best Practices)

(US $ mn)

Financial Year (April-March)	*Main Components*					*Share of new items in the total [(3)+(4)+(5)]/(6)x100*
	Equity Inflows (FIPB/SIA, Automatic & Acquisition Routes)#	*Equity capital of unincorporated bodies ##*	*Re-invested earnings +*	*Other capital +*	*Total FDI Inflows*	
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*
2000-01	2,339	61	1,350	279	4,029	41.95
2001-02	3,904	191	1,645	390	6,130	36.31
2002-03	2,574	190	1,833	438	5,035	48.88
2003-04	2,197	32	1,460	633	4,322	49.17
2004-05	3,250	528	1,904	369	6,051	46.29
2005-06	5,540	435	2,760	226	8,961	38.18
2006-07	15,585	896	5,828	517	22,826	31.72
2007-08	24,573	2,291	7,679	292	34,835	29.46
2008-09	27,329	702	9,030	777	37,838	27.77
2009-10(P) (+) (++)	25,609	1,540	8,669	1,945	37,763	32.18
2010-11(P) + *(up to Nov)*	14,025	437	4,237	303	19,002	26.19
Memorandum Items						
1991-92@- 1999-00	*15,483*	-	-	-	*15,483*	-
2000-01 to 2004-05	*14,264*	*1,002*	*8,192*	*2,109*	*25,567*	44.21
2005-06 to 2009-10	*98,636*	*5,864*	*33,966*	*3,737*	*1,42,223*	30.63
2000-01 to 2009-10	*1,12,900*	*6,866*	*42,158*	*5,846*	*1,67,790*	32.70

Source: Based on DIPP, "Fact Sheet on Foreign Direct Investment (FDI)", December 2009 and November 2010 and *RBI Bulletin* May 2010.

@ August 1991 to March 1992.

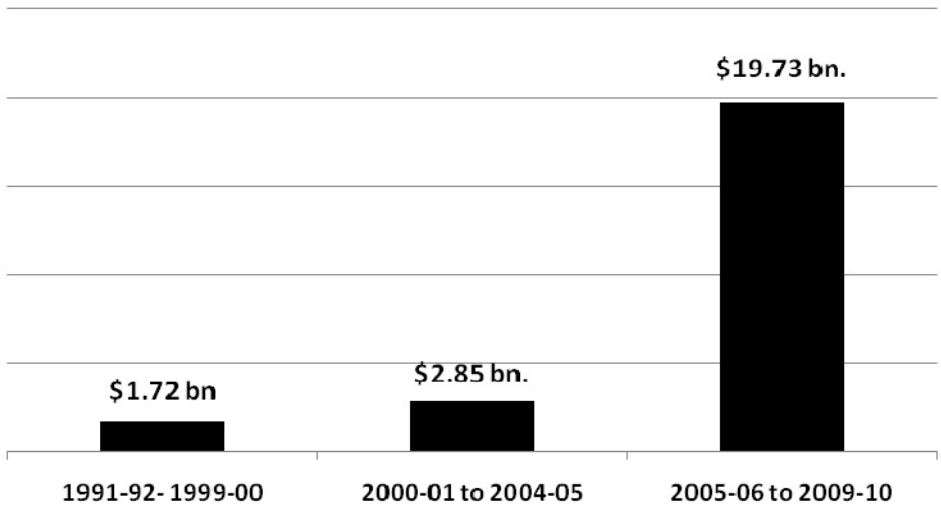
"+" (P) All figures are provisional and data in respect of 'Re-invested earnings' & 'Other capital' for the years 2009-2010 & 2010-11 are estimated as averages of previous two years.

++ Data on equity capital of unincorporated bodies, reinvested earnings and other capital pertains to the period from April 2009 to December 2009.

Hereafter referred to as FDI Equity Inflows.

Figures for equity capital of unincorporated bodies for 2009-10 are estimates.

Chart 1
Average Reported FDI Equity Inflows during Different Periods



Incidentally, in March 2005, the government announced a revised FDI policy, an important element of which was the decision to allow FDI up to 100% foreign equity under the automatic route in townships, housing, built-up infrastructure and construction-development projects.[57] The year 2005 also witnessed the enactment of the *Special Economic Zones Act*, which entailed a lot of construction and township development that came into force in February 2006.

Further, it can be seen from Table 5 that acquisition of existing shares of companies by foreign investors contributed substantially to the FDI Equity Inflows[58] and it peaked in 2005-06 and 2006-07 to reach almost two-fifths of the total FDI Equity flows. Acquisition of shares together with reinvested earnings (which do not represent actual inflows) account for a substantial proportion of the reported total inflows. (Chart 2) Another notable feature of the inflows is that the proportion of the inflows subject to specific government approvals declined from 62.25% in 2000-01 to 13.55% in 2009-10 reflecting the progressively greater freedom enjoyed by the foreign investors in making their investment decisions.

A development which provides a specific context to the present study is the sharp decline in the reported total FDI Equity inflows during the first eight months of 2010-11 – by 23.88% over the inflows of the corresponding period of 2009-10. The corresponding

[57] This includes, but not restricted to, housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure) subject to certain guidelines.

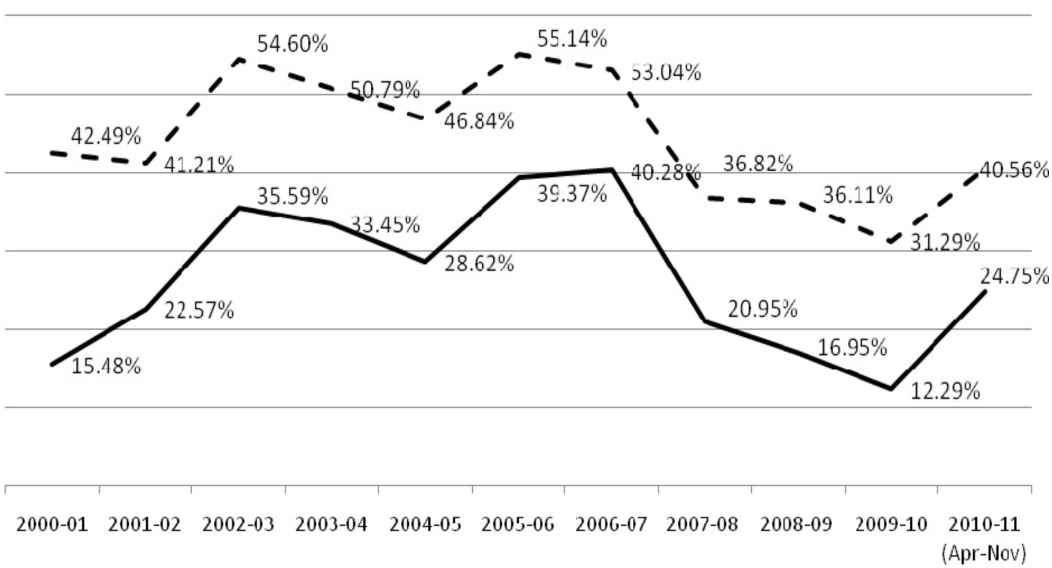
[58] Inflows through the FIPB/SIA, Automatic and Acquisition routes.

Table 5
Entry Route-wise Distribution of FDI Equity Inflows# in US $ mn

Year	*Entry Route*			*Total*	*Share in Total (%)*		
	FIPB/SIA	*Automatic**	*Acquisition of shares*	*(2)+(3)+(4)*	*FIPB/SIA*	*Automatic*	*Acquisition of shares*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*
2000-01	1,456	521	362	2,339	62.25	22.27	15.48
2001-02	2,221	802	881	3,904	56.89	20.54	22.57
2002-03	919	739	916	2,574	35.70	28.71	35.59
2003-04	928	534	735	2,197	42.24	24.31	33.45
2004-05	1,062	1,258	930	3,250	32.68	38.71	28.62
2005-06	1,126	2,233	2,181	5,540	20.32	40.31	39.37
2006-07	2,156	7,151	6,278	15,585	13.83	45.88	40.28
2007-08	2,298	17,127	5,148	24,573	9.35	69.70	20.95
2008-09	4,699	17,998	4,632	27,329	17.19	65.86	16.95
2009-10 (P)	3,471	18,990	3,148	25,609	13.55	74.16	12.29
2010-11 *(Apr-Nov)(P)*	1,604	8,950	3,471	14,025	11.44	63.81	24.75

Source: Based on Table No. 44, *RBI Monthly Bulletin*, January 2011, p. S 86.
Excluding investments in Unincorporated Bodies, Reinvested Earnings and Other Capital.
(P): Provisional
* Includes small quantities on account of NRI investment for the years 2000-01 and 2001-02.

Chart 2
Relative Contribution of Reinvested Earnings and Acquisition of Shares to FDI Inflows



------ Reinvested Earnings and Acquisition of Shares as % of Total FDI Inflows.
—— Acquisition of Shares as % of FDI Equity Inflows.

fall in FDI Equity inflows was 27.43%. UNCTAD estimated the fall in India's FDI inflows during the calendar year 2010 at 31%.[59] From Table 5 (and Chart 2) it can be seen that even this level of inflow was sustained by a sudden increase in the inflows through the acquisition route. From a share of 12.29% in the FDI Equity inflows of 2009-10, its share doubled to 24.75% in 2010-11. Acquisition related inflows in value terms during the first eight months of 2010-11 already exceeded that for the entire 2009-10. And it is the inflows through the automatic route which were affected substantially rather than those through the Foreign Investment Promotion Board/Secretariat for Industrial Assistance (FIPB/SIA) approval route suggesting that more than the problems in getting the approvals through, it is the voluntary restraint on part of the foreign investors which was responsible for the slow down. The major fall in FDI inflows has caused concern in policy making circles and has become a subject matter of public comments.[60] RBI in particular is now worried about the fall in FDI inflows in the context of higher level of current account deficit and dominance of volatile portfolio capital flows. The volatile FII inflows which accounted for a substantial proportion of the equity flows have in turn contributed to the volatility in equity prices and the exchange rate. RBI underlined the "sustainability risks' posed by the composition of capital flows and the need for recovery in FDI which is expected to have longer-term commitments.[61] Besides environmentally sensitive sectors like mining, integrated township projects and construction of ports, it identified the sectors responsible for the slow down as "construction, real estate, business and financial services".[62] It does appear that the role of FDI is now being seen more from the point of managing the current account deficit due to its more 'stable' nature,[63] rather than for it being a 'bundle of assets'.

The increased inflows have been characterised by a sharp change in their sectoral composition. By 2008, while the share of manufacturing declined to almost half of what it was in 2005[64], share of services increased the maximum with mining and agriculture

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[59] UNCTAD, "Global and Regional FDI Trends in 2010", *Global Investment Trends Monitor*, No. 5, January 17, 2011, available at http://unctad.org/en/docs/webdiaeia20111_en.pdf.

[60] A study by the Standard and Chartered Bank is reported to have identified issues relating to governance (e.g. scams, slow pace of public infrastructure projects and stalled economic reforms) and inflation have hurt investor confidence. It was suggested that unless more sectors are opened up and policies streamlined FDI inflows are unlikely to bounce back. See: "Governance, inflation hit FDI flow", at http://timesofindia.indiatimes.com/business/india-business/Governance-inflation-hit-FDI-flow/articleshow/7428514.cms. See also: Rajat Guha, "The FDI Trickle", *The Financial Express*, January 2, 2011.

[61] RBI, *Macroeconomic and Monetary Developments—Third Quarter Review 2010-11*, at http://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Macroeconomic%20and%20Monetary%20Developments&fromdate=01/23/2011&todate=01/25/2011

[62] *ibid.* p. 16.

[63] The Deputy Chairman of the Planning Commission is also credited with the view that "India needed FDI to bridge the rising current account deficit." See: "India attractive destination despite some slow down: Montek", at http://economictimes.indiatimes.com/news/politics/ nation/india-attractive-fdi-destination-despite-some-slowdown-montek/articleshow/7385709.cms

[64] Due to the change in reporting format (especially with regard to computer software and electronics) a comparison with the earlier years was not attempted here. Since the inflows increased substantially after

contd…

related activities receiving marginal amounts. Within services, Construction and Real Estate sector gained the most. The Financial services sector too gained in importance. Major setback was, however, experienced by the IT & ITES sector. While the Energy sector gained relatively, telecommunication services managed to retain its share. Construction & Real Estate and Finance are thus the major gainers in this period. (Table 6 and Chart 3) A further scrutiny of the data suggested that only a few of the Indian investee companies in the former can be categorised as engineering & construction companies like Punj Lloyd, Soma Enterprises and Shriram EPC and the rest are developers—a few of these were engaged in setting up IT Parks and SEZs. A similar examination of the inflows to the Financial sector suggested that close to 40% of the inflows were into companies that serve the securities market suggesting that they do not directly contribute to the financing needs of the Indian businesses. These could be termed as adjuncts to the foreign portfolio investors. In 2009, the situation changed somewhat. (Table 7) While the manufacturing sector gained marginally, the Construction and Real Estate sector improved its position further to claim more than one-fifth of the inflows. IT & ITES slipped even further with a share of just 2.55% of the total.

Table 6
Major Sector-wise Distribution of FDI Equity Inflows during 2005-2008#

Sector	*2005-2008*	*2005*	*2006*	*2007*	*2008*	*2005-2008*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*
Total Inflow (US $ mn)	64,423	4,354	11,119	15,921	33,029	64,423
Of which,		(% Share in Total Inflow for the Year)				
Manufacturing	13,436	41.41	17.44	18.67	20.35	20.86
Finance	12,114	11.68	19.77	18.08	19.77	18.80
Construction & Real Estate	10,754	3.12	11.50	17.41	19.88	16.69
Other Services	8,915	11.31	20.22	10.74	13.52	13.84
IT & ITES	7,016	21.21	17.25	15.18	5.32	10.89
Telecommunications	4,737	3.64	8.37	6.72	7.80	7.35
Energy	2,933	1.44	2.26	3.69	6.15	4.55
Trading	1,367	0.65	0.76	3.62	2.05	2.12
Mining	488	0.15	0.03	2.65	0.17	0.76
Agriculture	136	0.21	0.01	0.75	0.02	0.21
Unclassified	2,529	5.19	2.39	2.50	4.96	3.93
Total		100.00	100.00	100.00	100.00	100.00

Source: Based on the data provided in *SIA Newsletter* (various monthly and annual issues).
Excluding those into Unincorporated Bodies, Reinvested Earnings and Other Capital.

2005-06 and our aim is to understand the developments after 2005-06, this would be a limitation. A broad indication of the position in 2009 is given in Table 7.

Chart 3
Sectoral Composition of Reported FDI Equity Inflows during 2005-2008

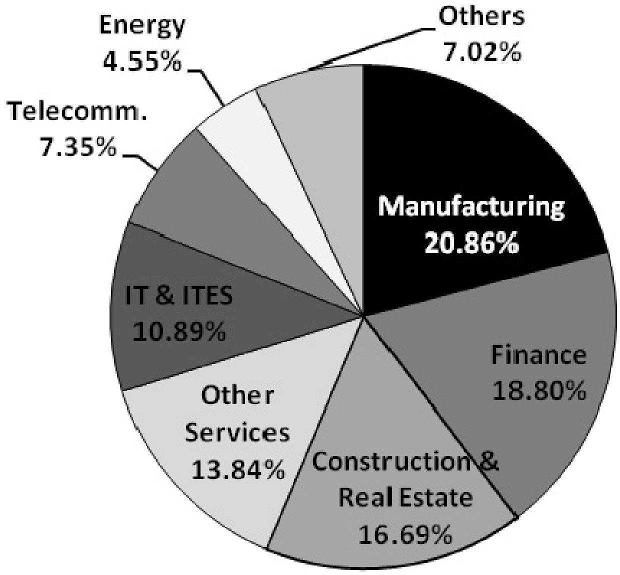

Table 7
Major Sector-wise Distribution of FDI Inflows in 2009

Sector	*Inflow(US $ mn)*	*Share in Total (%)*
(1)	*(2)*	*(3)*
1. Services Sector	18,871.60	69.78
Of which,		
- *Housing, Real Estate & Construction*	*5,658.40*	*20.82*
- *Telecommunications*	*2,557.65*	*9.50*
- *Agriculture Services*	*1,307.37*	*4.84*
- *Information & Broadcasting (Including Print Media)*	*782.77*	*2.90*
- *Computer Software**	*688.30*	*2.55*
2. Manufacturing	5,791.21	21.41
Of Which		
- *Automobile Industry*	*1,338.38*	*4.94*
- *Electrical Equipments*	*787.56*	*2.91*
- *Metallurgical Industries*	*470.73*	*1.74*
- *Chemicals (Other than Fertilizers)*	*451.36*	*1.69*
3. Energy	2,137.60	7.90
4. Others	243.73	0.91
Total	27,044.14	100.00

Source: Based on data available in *SIA Newsletter*, January 2010.
Excluding those into Unincorporated Bodies, Reinvested Earnings and Other Capital.
* Following the previous year's distribution, the share of computer software within the broad classification of 'Computer Software & Hardware' has been taken approximately as 96%.

Another important aspect of the inflows is the substantial shift in the immediate source country for FDI into India (Table 8). While the prominence of Mauritius for routing foreign capital to India has been well known, the more recent period witnessed further strengthening of Mauritius as the source country. For the period 2005 to 2009, the country accounted for practically half of the total reported inflows. Interestingly, Singapore secured the second position with Cyprus and UAE entering the group of top 10 home countries for FDI into India. Overall, countries categorised as tax havens accounted for much higher share of nearly 70% of the total FDI inflows during the more recent period compared to their share of 40% till 2000 or even the 45% in the immediate preceding period.

Table 8
India's FDI Equity Inflows*: Top 10 Home Countries Share (in percentage)

S.No.	*Country*	*Aug. 1991 to Dec. 2000*	*2001 to 2004*	*2005 to 2009*
	(1)	*(2)*	*(3)*	*(4)*
1	Mauritius	31.51	38.81	49.62
2	Singapore	2.76	2.22	11.33
3	U.S.A.	20.10	14.36	7.28
4	U.K.	5.44	7.80	5.64
5	Cyprus	0.20	0.18	4.41
6	Netherlands	5.19	9.48	3.83
7	Japan	7.41	7.32	3.22
8	Germany	5.61	4.13	2.61
9	U.A.E.	0.08	0.66	1.75
10.	France	2.59	3.22	1.24
	Sub-Total	80.90	88.19	90.80
	Others	19.10	11.81	9.20
	Total FDI Inflows#	100.00	100.00	100.00
	Memorandum Items: Nature of Source Country			
	(i) Premier Tax Havens	7.57	6.27	18.79
	(ii) Mid-Range Tax Havens	31.94	39.26	50.29
	(iii) Minor & Notional Tax Havens	0.01	0.02	0.09
	Sub-total Tax Havens (i+ii+iii)	39.51	45.55	69.17
	(iv) Others	60.49	54.45	30.83
	Grand Total	100.00	100.00	100.00

Source: Based on the data provided in *SIA Newsletter* (various monthly and annual issues). Classification of home countries into Tax Havens is based on: (1) Tax Justice Network, *Closing the Floodgates: Collecting Tax to Pay for Development*, 2007, commissioned by the Norwegian Ministry of Foreign Affairs and (2) United States Government Accountability Office, *Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions*, December 2008.

* Excluding NRI investments and those for which country details have not been reported. The ranking is based on their position in 2005-09.

3.2 Analysis of Individual Inflows

To understand the above developments better, we now turn to data on individual inflows reported for the period September 2004 -- December 2009 and analyse these by the sector, home-country type and nature of inflow route. A crucial element added by us to the official data is classification of the foreign investors. To keep the exercise within manageable limits while also retaining its representative character, we have chosen all the inflows each amounting to US $ 5 mn or more.[65] Out of the 29,233 reported inflows through *(i)* Foreign Investment Promotion Board (FIPB)/Secretariat for Industrial Assistance (SIA) approval route, *(ii)* automatic route and *(iii)* acquisition of existing shares of Indian companies by foreign investors covering an investment of US $ 92.36 bn (FDI Equity inflows), the relevant ones were 2,748. This data was taken from successive issues of the *SIA Newsletter*.[66] The 2,748 equity inflows accounted for $80.92 bn out of $92.36 bn or 87.61% of the total inflows reported for the period by the SIA on its website. Since these are individual inflows and a company could have received inflows more than once during the period, we have tried to identify individual companies by taking into account name changes that have occurred. We could thus identify 1,659 recipient companies corresponding to these 2,748 cases of inflows.[67] One major lacuna of this data source is that it does not reveal the share of the foreign investor in the Indian investee company. Since only a few of the 1,659 companies were listed on the Indian stock exchanges, we could not independently ascertain the foreign shares in most cases.

From Table 9 it can be seen that the sectoral distribution of inflows represented by the top 2,748 cases broadly corresponds to the overall distribution presented in Table 6. Only about 15% of the selected inflows were subjected to a formal approval process. Overall, about 21% of the inflows were on account of acquisition of existing shares by foreign investors. This practice was, however, more prominent in the case of IT & ITES companies. A word of caution is, however, called for in interpreting the data on acquisitions as the inflows reported under this head could be under-representing the extent of acquisition of *existing businesses* by foreign investors in India.[68] The inflows

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[65] It is quite possible that the same combination of foreign investor and Indian investee company might have reported other inflows too but which were lower than $ 5mn each. These however, were not taken into account in this exercise.

[66] The individual elements of information on inflows are: name of the foreign investor, name of the country from which the amount was remitted, name of the recipient Indian entity, product/activity of the venture, inflow in Indian rupees and equivalent US $. The *SIA Newsletter* offers three lists, one each for FIPB/SIA approvals, payment against acquisition of existing shares and inflows recorded by the RBI under the automatic route.

[67] The number of companies is only an approximation as we might not have been able to take note of all the name changes in case of Indian investee companies.

[68] Preliminary results of an ongoing study suggest that inflows into acquired companies accounted for a little less than half of the total FDI inflows (other than that classified as portfolio/PE/VC/HF/round-tripping, etc.) into manufacturing companies See: K.S. Chalapati Rao and M.R. Murthy, "Location of FDI in India: A Discussion of Some Less Explored Aspects", paper presented in the international seminar *The Globalization of Production Models and Innovation in Emerging Economies: Comparative Research on Subnational Industrial Policies*, *contd…*

reported under this category should reflect purchase of shares of companies incorporated in India in the *process of their takeover* by foreign companies. A few illustrative cases given in Annexure A show that the reported data do not uniformly reflect this process. For instance, the 2,748 large inflows selected by us for detailed examination have three entries relating to Cementrum BV's (Netherlands) investment in Mysore Cements Ltd. Two entries are reported as being under the Acquisition Route and the third under the Automatic Route. Possibly this is due to the fact that the former two relate to the transfer of existing shares of Mysore Cements to Cementrum and in case of the third one, newly created shares of Mysore Cements (expansion of capital) were issued to Cementrum.

Table 9
Sector and Entry Mode-wise Distribution of Top 2,748 Reported FDI Inflows#
during September 2004 and December 2009

	No. of Companies	*Inflow (US $ mn)*	*Share in Total (%)*	*Shares of Different Routes of Inflow (%)*			
				FIPB/SIA Approval	*RBI Automatic Route*	*Acquisition*	*Total*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*
Manufacturing	492	18,015	22.26	19.59	56.56	23.85	100.00
Services	1,084	54,739	67.65	14.81	65.87	19.32	100.00
Real Estate & Construction	382	14,526	17.95	2.85	88.68	8.47	100.00
Financial	194	13,974	17.27	18.96	64.60	16.44	100.00
IT & ITES	147	8,283	10.24	10.44	43.73	45.83	100.00
Telecommunications	25	6,292	7.78	29.58	58.72	11.70	100.00
Other Infrastructure	50	4,364	5.39	7.08	64.65	28.26	100.00
Research & Development	5	90	0.11	27.73	56.70	15.57	100.00
Other Services	281	7,209	8.91	27.50	54.92	17.58	100.00
Energy	75	6,251	7.72	3.57	81.06	15.37	100.00
Mining & Agriculture	8	1,911	2.36	1.23	30.01	68.75	100.00
Grand Total	1,659	80,915	100.00	14.68	64.13	21.19	100.00

Source: Based on the actual inflows reported in the monthly issues of SIA Newsletter.
Each amounting to US $ 5 mn or more.

There is also the possibility of when a division/unit of an existing company was taken over by a foreign company it may not always be reported as an acquisition by the same company. What appears to have been followed is that when the foreign investor bought the shares which were already held by another investor, it is treated as a case of acquisition and when new shares of the target are issued to the same foreign investor they are reported under the FIPB/SIA or Automatic Routes as the case may be. It is

held at the Institute for Studies in Industrial Development, New Delhi, during November 19–20, 2010.

obvious that both these type of inflows are related to a takeover of an Indian company. There could be justification for treating them differently if fresh shares are issued after a long gap when the foreign investor felt the need to infuse more funds to revive the business or expand it. Further, for a proper assessment of the M&A situation in India, it is essential to take note of the acquisition of specific business units of companies as distinct from takeover of the companies themselves. A few illustrative such cases involving foreign companies are listed in Table 10.[69]

Table 10
Illustrative Cases of Business Unit Transfers to FDI Companies

Acquirer	*Acquired Division of*
Birla NGK Insulators Pvt Ltd	Jayshree Insulator unit of Indian Rayon. & Industries Ltd
EBG India Pvt Ltd (now Thyssen Krupp Electrical Steel India Pvt Ltd)	Steel division of Raymond Ltd
FCB - KCP Ltd	Sugar Machinery Division of KCP Ltd
KBX Motorbike Products Pvt Ltd	Kalyani Brakes' two-wheeler brake production
Kirloskar Copeland Ltd	Compressor manufacturing division of Kirloskar Brothers Ltd
Lafarge Aggregates & Concrete (I) Pvt Ltd	Concrete mix division of Larsen & Toubro Ltd
Lafarge India Pvt Ltd	Tata Steel's Cement Plant
Lafarge India Pvt Ltd	Cement division of Raymond Ltd
Lanxess India Pvt Ltd	Chemicals & wind power business of Gwalior Chemical Industries Ltd
Novozymes South Asia Pvt Ltd	Enzymes business of Biocon
Osram India Pvt Ltd	Lighting Davison of ECE Industries Ltd
Parry Monsanto Seeds Pvt Ltd	Seeds division of EID Parry India Ltd
Raymond UCO Denim Pvt Ltd	Denim unit of Raymond Ltd was transferred to the JV
Sinochem India Pvt Ltd	Butachlor and alachlor businesses of Monsanto India
South Asia Tyres Ltd	2 & 3 - wheeler tyre unit of Ceat.
Tecumseh Products India Pvt Ltd	Compressor manufacturing unit of Shriram group
Thyssenkrupp ECE Elevator Pvt Ltd	Elevator Division of ECE Industries Ltd
VE Commercial Vehicles Ltd	LCV unit of Eicher Motors Ltd
Vetoquinol India Animal Health Pvt Ltd	Animal healthcare business of Wockhardt Ltd

While the manufacturing sector stood at the top with the largest number of companies, its share in the amount received was considerably lower. In terms of number of recipients, Construction & Real Estate stood at the second position with as many as 382

[69] This phenomenon was discussed earlier in some detail in S.K. Goyal, et. al., *Foreign Investment Approvals and Implementation Status: A Review (August 1991 – December 1994),* Institute for Studies in Industrial Development, March 1995.

companies. It is interesting to note that only a small proportion (2.85%) of the foreign investment in Construction and Real Estate sector entered through the formal approval route. The Financial sector also has a relatively better position both with regard to the number of companies as also the inflows. While inflows to Mining & Agriculture sectors were subject to least approval mechanism, their share in the total was quite low. The Energy sector is also largely free from initial approval process. R&D (excluding the companies covered in IT&ITES) attracted a miniscule share of the inflows represented by the 2,748 cases.

In order to further understand the nature of reported FDI inflows, which could indicate the possible behaviour of the foreign investors and their contribution to enterprise development, we have classified the foreign investors into different categories keeping in mind the discussion on concepts presented in Section II. The classification heavily relied upon of websites of companies, newspapers, analysts, professional bodies, consultants, investment advisers, etc. as also and ISID Press Clippings archives. Foreign companies which invested in their own area of functioning irrespective of the sector they are engaged in have been categorised as FDI investors.[70] This is because an investor investing in his own line of activity *could directly contribute* to the functioning of the investee company. Since it was not possible to get the foreign share in each of the companies, all those cases were uniformly treated as FDI. Since there could be some passive investments, our estimate of FDI could be on the higher side. All individual investors whose names suggest that they could be of Indian origin and companies known to have been promoted by them are termed as NRIs. Investments by banks and other financial intermediaries (unless these are in their own respective sectors) are termed as Other Portfolio investments as the main objective of such investments could be capital gains and they on their own may not be able to add directly to the functioning of the domestic investee company. For instance, a bank investing in a manufacturing company is identified as a portfolio investor (e.g., investments of HSBC Bank and Royal Bank of Scotland in Reliance Ports and Terminals Ltd). This is because their involvement could at best be like a financial investor who (whether domestic or foreign) might seek representation on the recipient company's board in case of substantial investments. The same, however, is classified as FDI in case the recipient Indian entity is a bank. Other portfolio investors known to be in the private equity/venture capital activity, hedge funds or sovereign wealth funds (SWF) have been classified as PE/VC/HF investors.[71] There have been some important cases where no specific information was available from

[70] However, cases like Cargill Holdings BV investing in Cargill Capital & Financial Services Pvt Ltd. and HPFS Venture Holdings Ltd. investing in Hewlett Packard Financial Services (India) Pvt Ltd. are also treated as FDI.

[71] While venture capital is a subset of private equity and has a different connotation in respect of risky and high technology ventures, available information does not enable an easy and clearcut distinction between the two. Hence these are very often referred to together.

any source. The classification of such investments took into account the circumstances of the investment and as such there could be some subjective element.[72]

Inflows by those who have their main base in India and who have expanded out of India have been treated as cases of Round-tripping. This is irrespective of whether the money brought in by them is raised abroad from other investors, might have been taken out from India by them at some point in the past or generated out of their past foreign investments. In a way this is expected to reflect the fact that control over the investee company remains with Indians who have strong base in India and except for capital inflow there would not be any additionality in terms of foreign management expertise, technology, etc. Apart from the well-known cases of Essar group, Zee Tele group and Vedanta/Sterlite group, we could identify some more with the help of internet. For instance, Biometrix Marketing Pvt Ltd of Singapore is a subsidiary of Reliance Genemedix PLC (which the Reliance Life Sciences group took over in early 2007). In view of this, the investments of Biometrix in Reliance Ports & Terminals Ltd, Relogistics Infrastructure, Reliance Utilities Ltd and Reliance Gas Transportation Infrastructure Ltd have been put under the round-tripping category by us. The investments by Ballarpur Paper Holding BV and NQC Global (Mauritius) Ltd in Bilt Graphic Paper Products Ltd and Bilt Paper Holdings Ltd respectively were also placed in this category. Similar is the case with the investments by Ishaan Real Estate and Unitech Corporate Parks (See Annexure B for an illustrative list and Annexures C1, C2 & C3 for diagrammatic representation of three sets of companies).[73] We have also classified the investment of Hitech Infra Ltd (Mauritius) in Krishnapatnam Port Co Ltd (KPCL) as a case of Round-tripping.[74]

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72 A relevant case is that of Travorto Holdings Ltd of Cyprus which is reported to have invested ₹1,418 crore in Tata Capital Ltd. Neither a perusal of the prospectus nor a search of the internet or even the documents filed by Tata Capital with the ROC (available on the Ministry of Corporate Affairs website) yielded any details of the foreign investor. It could be any thing: A PE/VC investor, a case of round-tripping or simple portfolio capital seeking good return or FDI by a foreign financial institution. We have classified it as portfolio investment. Another important case is that of Gypsy Rover (or Gytsy Rover?), a foreign investor in BPL Mobile communication Ltd., about which only suggestive information is available but no confirmation could be made. Given the circumstances in which it was made, we have treated it as a case of round-tripping. See for instance: "Gypsy Rover Mystery Deepens" at http://economictimes.indiatimes.com/articleshow/3830644.cms?prtpage=1.
Another case which we could finally trace as an OCB belonging to Mr. P.K. Jani and his associates is that of Satin Ltd of British Virginia, a non-promoter shareholder of Standard Industries Ltd with 38.86% share in equity.

73 Here too one finds the leading international audit firms playing multiple roles.

74 It has been reported that Hitech Infra had common directors with KPCL and that it had borrowed funds from the Bahrain branch of ICICI. The proposal was reported to have been approved by the FIPB overruling the objections raised by the Department of Revenue in the Ministry of Finance. See: http://steelguru.com/news/index/Njg5Mjk%3D/FIPB_approves_Hitech_Infra_investment_in_Krishnapatnam_Port%250D%250A.html (accessed last on May 21, 2010). KPCL also received investment from (i) Chinta Investment Private Co Ltd; (ii) CVR Investments Pvt Co Ltd; and (iii) Navaneeta Investments Pvt Co. Ltd (all of Mauritius) for which post-facto approval was given by the Government. Incidentally, the group is known as CVR Group (after the founder's name C. Visweswara Rao) and Chinta is the surname of the promoter family. Two of the Indian shareholders of the company are: Navaneeta Agriculture Development Co Ltd and Navaneeta Agritech Pvt Ltd. (See the

contd…

It is relevant to underline here that a good number of companies listed on the London Stock Exchange which have operations in India and which appear to be controlled by Indians are registered in tax havens. (Table 11) some of these in turn have set up SPVs in Mauritius to

Table 11
London Stock Exchange Listed Companies whose Control Appears to be with Indians and which Invested in India

Company	*Country of Incorporation*	*Activity*	*Listing Date*
(1)	*(2)*	*(3)*	*(4)*
West Pioneer Properties Ltd	British Virgin Islands	Real Estate Holding & Development	13-12-2006
India Hospitality Corp	Cayman Islands	Restaurants & Bars	24-07-2007
Indus Gas Ltd	Guernsey, Channel Islands	Exploration & Production	06-06-2008
Skil Ports & Logistics Ltd	Guernsey, Channel Islands	Transportation Services	07-10-2010
IEnergizer Ltd	Guernsey, Channel Islands	Business Support Services	14-09-2010
Greenko Group PLC	Isle of Man	Alternative Electricity	07-11-2007
DQ Entertainment PLC	Isle of Man	Broadcasting & Entertainment	18-12-2007
Eros International PLC	Isle of Man	Broadcasting & Entertainment	04-07-2006
KSK Power Ventur PLC *	Isle of Man	Electricity	31-03-2010
OPG Power Venture PLC	Isle of Man	Electricity	30-05-2008
Dhir India Investments PLC	Isle of Man	Equity Investment Instruments	12-07-2007
Elephant Capital PLC	Isle of Man	Equity Investment Instruments	25-04-2007
Hirco PLC	Isle of Man	Real Estate Holding & Development	13-12-2006
Ishaan Real Estate PLC	Isle of Man	Real Estate Holding & Development	24-11-2006
Unitech Corporate Parks PLC	Isle of Man	Real Estate Holding & Development	20-12-2006
Jubilant Energy N.V.	Netherlands	Exploration & Production	24-11-2010
Photon Kathaas Productions Ltd	Singapore	Broadcasting & Entertainment	04-11-2010
Mortice Ltd	Singapore	Business Support Services	15-05-2008
Essar Energy PLC *	UK	Integrated Oil & Gas	07-05-2010
Vedanta Resources *	UK (Parent in Bahamas)	General Mining	10-12-2003

Except for those marked with an asterisk (*) which are listed on the UK Main Market, all are listed on the Alternative Investment Market (AIM) of the London Stock Exchange.

company's filing with the Bombay Stock Exchange available at: http://www.bseindia.com/downloads/ipo/200933116251KPCL-Disclosure%20Document%20-Final.pdf. (accessed last on May 21, 2010) invest in India. While we do not know how the shareholding of the founders was financed, in a few cases institutional investors appear prominently in the list of shareholders. To that extent, it suggests that FII funds instead of coming directly into the Indian stock market, in which case they would have been classified as portfolio capital, are coming via the LSE listed companies into India as FDI. Had they subscribed to GDR/ADRs of Indian companies, the funds would again have been classified as foreign portfolio inflows. This was the case with some other non-Indian controlled LSE listed companies as well. As we shall see later, since a good part of such inflows was not subjected to the FIPB/SIA route, one could say that it is neither subjected to FII nor FDI regulations.

Going by the foregoing criteria, out of the total $81 bn inflows under study less than half can be termed as FDI. The next most important category is PE/VC/HF with almost 27% in the total followed by the Round-tripping variety with a share of about 10%. It needs to be specified here that Round-tripping investments which also have the characteristics of PE/VC/HF have been clubbed with total PE/VC/HF investments. If these are also taken into account, the share of Round-tripping investments will work out to about 14% of the total. Other portfolio investments work out to a little more than 9% and NRI investments, some of which can be termed as portfolio investments, are about 5% of the total. What strikes one most is that PE/VC/HFs were more important in case of the services sector compared to the manufacturing sector. (Table 12 and Chart 4) Within the services, they were more important for the Construction & Real Estate sector. What could be termed as FDI accounts for only 13%

Table 12

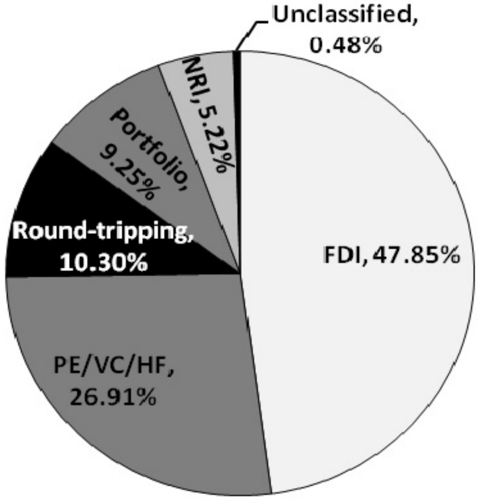
Sector and Type of Foreign Investor-wise Distribution of Top 2,748 Inflows

Sector	*Total Inflow (US $ mn)*	*Share of Different Types of Foreign Investors (%)*						
		FDI	*Other Portfolio*	*PE/VC/ HF #*	*Round Tripping Only*	*NRI*	*Unclassified*	*Total*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*	*(9)*
Total	80,915	47.85	9.25	26.91	10.30	5.22	0.48	100.00
A. Manufacturing	18,015	61.57	8.82	15.48	8.05	5.47	0.61	100.00
B. Services	54,739	44.06	8.51	31.80	9.85	5.28	0.49	100.00
Construction & Real Estate	14,526	12.82	9.77	58.17	13.25	4.43	1.56	100.00
Financial	13,974	58.70	5.11	29.09	2.62	4.28	0.21	100.00
IT & ITES	8,283	61.35	2.85	19.95	1.19	14.66	0.00	100.00
Telecommunications	6,292	80.75	3.79	7.66	7.80	0.00	0.00	100.00
Other Infrastructure	4,364	14.11	29.60	13.15	38.19	4.96	0.00	100.00
Research & Development	90	56.87	0.00	43.13	0.00	0.00	0.00	100.00
Other Services	7,209	44.72	10.55	29.79	11.71	3.03	0.19	100.00
C. Energy	6,251	36.08	19.10	18.72	20.47	5.52	0.10	100.00
D. Mining & Agriculture	1,911	65.42	1.99	21.43	11.16	0.00	0.00	100.00

Source: See Table 9.

includes investment that could be categorised as round-tripping.

Chart 4
Type of Investor-wise Distribution of Top 2,748 Inflows



of the inflows into this sector.[75] This sector's inflows are also important for Round-tripping investment. Most of the investment in the Telecommunications sector is in the form of FDI. Understandably, the R&D sector (excluding the IT&ITES) received investment only from two types of investors: either FDI or PE/VC/HF. Other infrastructure sectors depended heavily on portfolio or Round-tripping investment. In a way, this might be suggestive of the position that in most of the infrastructure sectors foreign investment offered little except for financial resources. The financial sector too was exposed to a large proportion of PE/VC/HF investments and portfolio capital.

While FDI accounted for less than half of the total inflows studied, only a little more than one-fourth of it went into the Manufacturing sector which means that manufacturing FDI accounted for just about 14% of the total reported inflows during the period. (Table 13) A good percentage of it went into Financial services (21.19%), IT&ITES (13.12%) and Telecommunications (13.12%). Important recipients of portfolio capital are manufacturing (21.25%), Construction and Real Estate (18.97%), other infrastructure (17.26%) and Energy (15.96%). Construction and Real Estate sector had the lion's share of investments by PE/VC/HFs with 38.8% share followed by Financial Services with 18.67%. The Manufacturing Sector received 12.81% of their investment. Prominent recipients of Round-tripping investment are Construction and Real Estate (23.10%), Other Infrastructure (20%) and Energy (15.22%). While 80% of the PE/VC/HF investment is in the Services sector, Construction and Real Estate alone accounted for 38.80% of the total followed by the financial sector with 18.67%. Though *total* Round Tripping investments were slightly more evenly distributed compared to PE/VC/HF investments, nearly 70% of it is in services with Construction and Real Estate alone claiming one-third. Interestingly, 60% of the

[75] This is by companies like EMAAR of UAE and Capitaland of Singapore.

investment that could simultaneously be classified as both PE/VC/HF and Round-tripping went into the Construction and Real Estate sector. (Chart 5)

Table 13

Sectoral Distribution of Various Types of Top 2,748 Inflows (in Percentages)

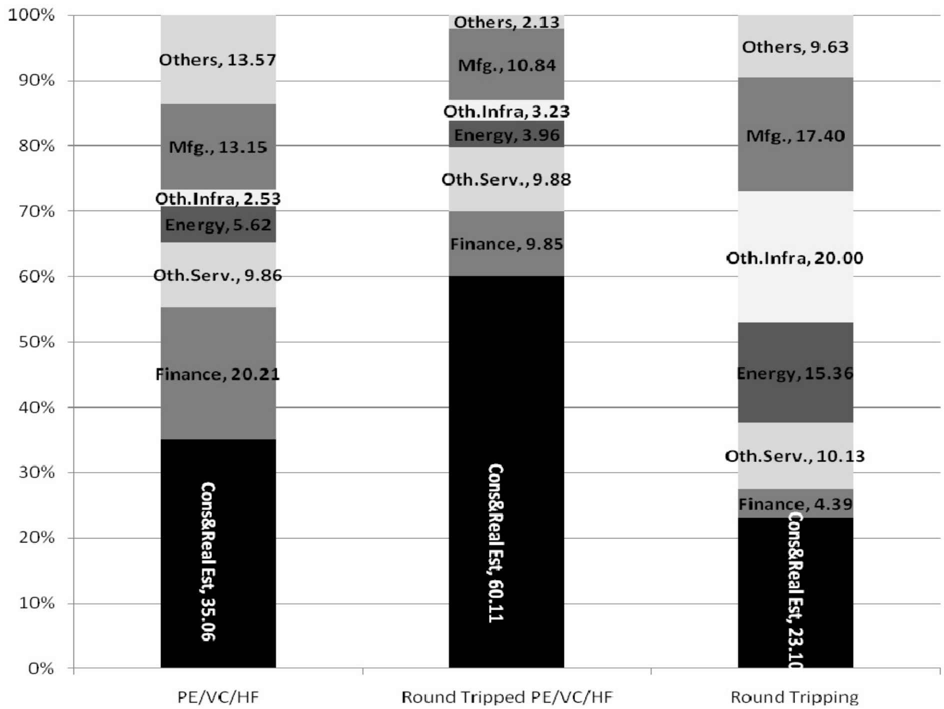
Sector	*FDI*	*Portfolio*	*PE/VC/HF (incl. Round Tripping)*	*Round Tripped PE/VC/HF*	*Round Tripping (excl. PE/VC/HF)*	*Round Tripping Total*	*NRI*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*
Manufacturing	28.65	21.25	12.81	10.84	17.40	15.56	23.35
Services	62.30	62.29	79.94	85.19	64.69	70.45	68.48
Construction & Real Estate	4.81	18.97	38.80	60.11	23.10	33.49	15.25
Financial	21.19	9.54	18.67	9.85	4.39	5.92	14.16
IT & ITES	13.12	3.16	7.59	1.75	1.18	1.34	28.77
Telecommunications	13.12	3.19	2.21	3.23	5.89	15.29	0.00
Other Infrastructure	1.59	17.26	2.63	0.38	20.00	4.34	5.12
Research & Development	0.13	0.00	0.18	0.00	0.00	0.00	0.00
Other Services	8.33	10.17	9.86	9.88	10.13	10.06	5.18
Energy	5.83	15.96	5.37	3.96	15.36	12.16	8.18
Mining & Agriculture	3.23	0.51	1.88	0.00	2.56	1.84	0.00
Grand Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: See Table 9.

Note: Unclassified ones are not shown here.

Chart 5

Sectoral Composition of Private Equity and Round-Tripped Investments



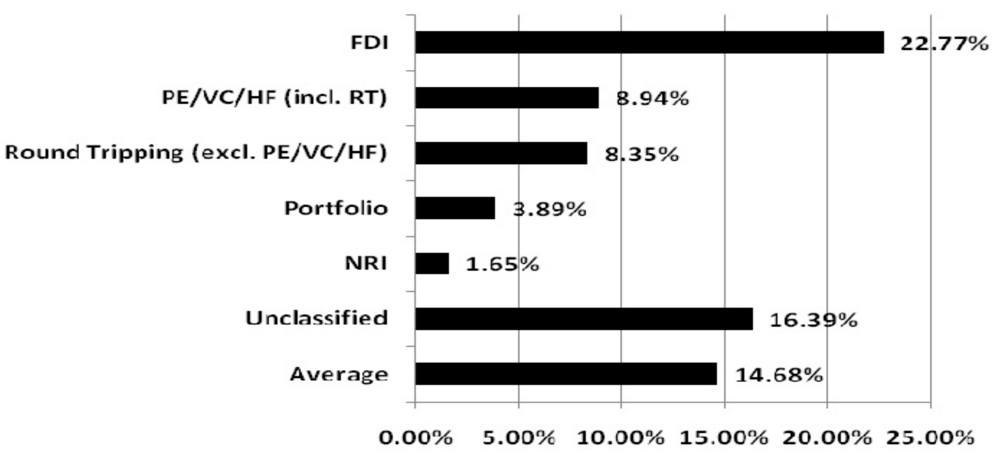
Interestingly, almost three-fourths of the PE/VC/HF capital which is a prominent source for the Construction & Real Estate sector, came through the automatic route. A further 17% followed the acquisition route with only about 9% being subjected to government approval. (Table 14 and Chart 6) Similar is the case with the inflow that could be termed as Round-tripping. One-third of the Other Portfolio capital took the acquisition route thereby suggesting that much of it was not adding to the existing investment. In any case, it is unlikely to be interested in/capable of directly contributing to enhance the functioning of the investee companies. While the proportion of inflows that are subject to a formal approval process is generally low, the proportion surprisingly is the highest for FDI. It does appear that an overwhelming portion of the foreign investment made under categories other than FDI does not go through a formal approval process. At 36%, non-acquisition type FDI accounts for only a shade over one-third of the total report equity inflows.

Table 14
Foreign Investor-wise and Entry Route-wise Distribution of the 2,748 FDI Inflows in Percentages

Type of Foreign Investor	*Total Inflow ($ mn)*	*FIPB/SIA Approval*	*RBI Automatic*	*Acquisition*	*Total*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*
FDI	38,717	22.77	52.99	24.25	100.00
Portfolio	7,481	3.89	62.55	33.56	100.00
PE/VC/HF *(incl. RT)*	21,778	8.94	74.07	17.00	100.00
Round Tripping *(excl. PE/VC/HF)*	8,333	8.35	73.70	17.95	100.00
NRI	4,222	1.65	97.12	1.23	100.00
Unclassified	385	16.39	83.61	0.00	100.00
Grand Total	80,915	14.68	64.13	21.19	100.00

Source: See Table 9.

Chart 6
Share of Inflows subjected to Specific Government Approvals for Different Types of Inflows



An important and well-recognised dimension of India's FDI is the fact of foreign investors' extensive use of recognized tax havens for entry into India. Table 15 (and Chart 7) presents the use of such countries by different categories of foreign investors. In a number of cases, predominantly NRIs and acquisition cases, the data source did not report the country of the foreign investor. For purposes of this exercise, such cases had to be excluded. While in the overall, the share of tax havens conforms to the general pattern, it is apparent that the route is exploited more by investors under the PE/VC/HF and

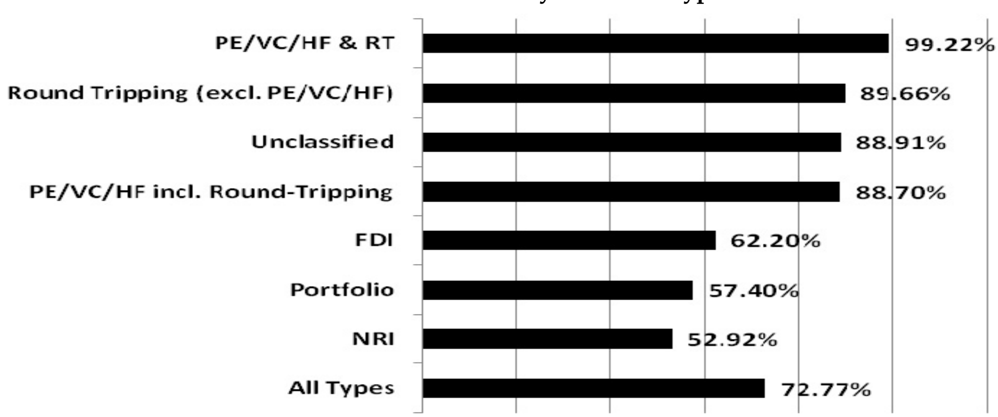
Table 15
Type of Foreign Investor-wise and Source Country Type-wise Distribution of the 2,748 FDI Equity Inflows

Type of Foreign Investor	*Total Inflow ($ mn)*	*Of which*		*Share of Different Types of Source Countries (%) (classified investments only)*			
		*Classified**	*Unidentified*	*Premier Tax Havens*	*Other Tax Havens*	*Other Countries*	*Total Classified*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*
FDI	38,717	34,874	3,843	15.93	46.27	37.80	100.00
Portfolio	7,481	4,552	2,929	25.73	31.67	42.60	100.00
PE/VC/HF incl. Round-Tripping	21,778	20,985	793	15.84	72.86	11.30	100.00
PE/VC/HF & RT	*3,252*	*3,134*	*98*	*7.23*	*91.99*	*0.78*	*100.00*
Round Tripping (excl. PE/VC/HF)	8,333	7,508	825	30.07	59.59	10.34	100.00
NRI	4,222	1,444	2,778	50.94	1.98	47.07	100.00
Unclassified	385	375	10	40.16	48.75	11.09	100.00
Grand Total	80,915	69,737	11,179	18.92	53.85	27.23	100.00

Source: See Table 9.

* Excluding the cases where the country of the foreign investor was not identified. These mostly involved the acquisition of existing shares and NRIs. For the basis of country classification, see: Table 8.

Chart 7
Share of Tax Havens in the Inflows by Different Types of Investors



Round-tripping categories. Further from Table 16 (and Chart 8) it can be seen that Telecommunications, Construction and Real Estate activities as also IT/ITES extensively used the tax havens which by all indications could not be the primary home countries. Manufacturing and Energy sectors used this route to the least extent. Practically the entire amount that is Round-tripped by Indian PE/VC/HF investors came through tax-havens as indicated by Bain & Co and cited in Section II.

Table 16
Sector-wise and Source Country Type-wise Distribution of FDI Inflows

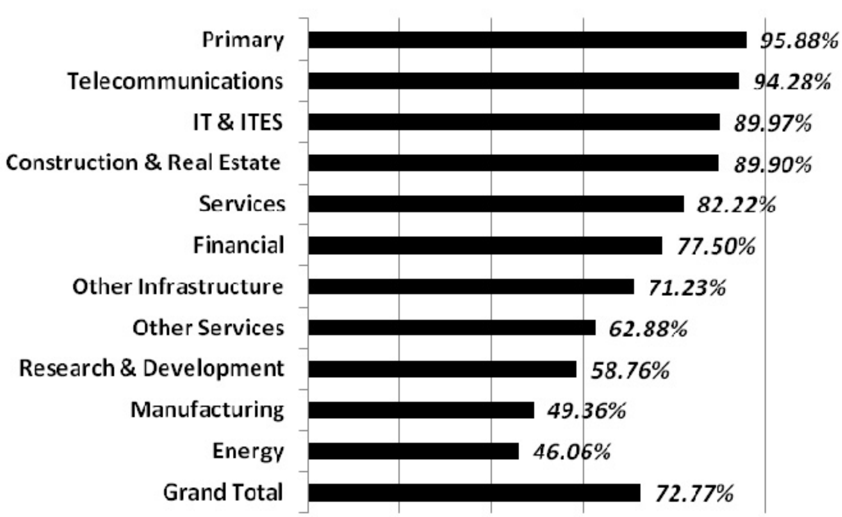
Sector	*Identified Inflows * ($ mn)*	*Share of Different Types of Source Countries (%)*			
		Premier Tax Havens	*Other Tax Havens*	*Other Countries*	*Total*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*
Manufacturing	14,484	17.15	32.21	50.64	100.00
Services	49,399	19.72	62.51	17.78	100.00
Construction & Real Estate	13,256	15.71	74.19	10.10	100.00
Financial	12,683	23.12	54.38	22.50	100.00
IT & ITES	7,481	17.13	72.83	10.03	100.00
Telecommunications	5,742	9.39	84.90	5.72	100.00
Other Infrastructure	3,516	48.33	22.90	28.77	100.00
Research & Development	90	0.00	58.76	41.24	100.00
Other Services	6,630	18.17	44.71	37.12	100.00
Energy	5,283	11.10	34.96	53.94	100.00
Primary	572	67.19	28.68	4.12	100.00
Grand Total	69,736	18.92	53.85	27.23	100.00

Source: See Table 9.

* Excluding the cases where the country of the foreign investor was not identified. These mostly involved the acquisition of existing shares and NRIs.

For the basis of country classification, see: Table 8.

Chart 8
Share of Tax Havens in the FDI Equity Inflows of Different Sectors



3.3 Other Aspects

Apart from these broad but important characteristics of the inflows, we did come across certain aspects of the reported inflows which suggest that the reported inflows may not strictly conform to the international practice of identifying an FDI relationship. For instance, some of the reported inflows into listed companies did not appear among the shareholders with at least 1% shareholding either because they had already withdrawn their investment or their share (either initially or remaining at the end of December 2008) amounted to less than 1% of the investee company's equity capital.[76] Further evidence to the fact that not all inflows would qualify to be FDI in the sense that is normally understood is provided in Table 17 and Table 18. The foreign investors shown in Table 17, most of which are evidently investment companies/fund managers do not qualify as FDI even on the basis of the percentage of shares held by them. We have classified these investments under PE/VC/HF or portfolio categories as the case may be. It would be difficult to visualize that 'Various FIIs' and NRIs would exhibit the characteristics associated with foreign direct investors. Similar is the case with the individuals shown in Table 19 who probably subscribed to the shares of a housing project. It is highly unlikely that anyone of them would be holding a stake that would exert significant influence on the management of Home Sweet Home Developers Ltd.

Further, irrespective of the perspective regarding PE/VC/HF investments, it is difficult to visualize the types of inflows shown in Tables 18 & 19 and the ESOPs given to the employees of HCL Technologies Ltd, as FDI. Even going by the internationally adopted criteria all these inflows should have been treated as portfolio capital. This opens up a critical aspect of reporting of FDI data in India. Irrespective of the share of such inflows in the total reported FDI, these examples are important because they illustrate that India has not been looking for the critical aspects of internationally propagated FDI definition in classifying the inflows. While international best practices are sought to be followed, the critical aspects of minimum qualifying share in equity capital, ability to significantly influence management and lasting interest may not have been taken into consideration while compiling India's FDI statistics. This was evident from the discussion presented in Section II.

Merely looking for 10% share of a *single foreign shareholder* for identifying an FDI company, which the RBI seems to have followed for its studies on Finances of FDI Companies, without taking into consideration that could be a portfolio investor (including an FII) opens up the possibility of classifying the companies listed in Table 20 as FDI companies. It would be difficult to visualise that these can exhibit the characteristics associated with an FDI company and that the foreign shareholder would contribute anything more than risk capital (if the shares were acquired in the secondary

[76] There is, however, a possibility that some of the foreign investors might have subscribed to convertible preference shares/bonds which could get reflected in the equity after conversion.

Table 17
Reported FDI inflow into Some Listed Companies

Indian Company	*Foreign Investor*	*Inflow Route & Month and Year of Reporting*	*Share (%) in Equity Capital as on 31-12-2008*
(1)	*(2)*	*(3)*	*(4)*
ABG Shipyard Ltd	Merlion India Fund I Ltd	R-Oct.2005	8.76
Allcargo Global Logistic Ltd	New Vernon Pvt Equity Ltd	R-Oct.2006	3.81
Anant Raj Industries Ltd	Master Trust Bank of Japan Ltd. A/c HSBC Indian Equity Mother Fund	R-Apr-Sep. 2006	1.36
Anant Raj Industries Ltd	Quantum (M) Ltd	R-Apr.2008	1.50
Anant Raj Industries Ltd	Lehman Brothers Asia Ltd	R-Apr-Sep.2006	1.82
Bharat Hotels Ltd	Dubai Ventures Ltd	R-May.2008	5.00
Dalmia Cement (Bharat) Ltd	Boron (I) Ltd	R-Oct.2006	4.42
Development Credit Bank Ltd	GRA Finance Corpn. Ltd.	R-Dec.2007	1.87
Edelweiss Capital Ltd	Lehman Brothers Netherlands Horizon BV	R-Feb.2008	1.80
Edelweiss Capital Ltd	Shuaa Capital Psc	R-Feb.2008	2.20
Hexaware Technologies Ltd	GA Global Investments Ltd	R-Nov.2007	7.36
Indiabulls Financial Services Ltd	Deutsche Bank Trust Company	R- Aug.2005	1.31
Jindal Poly Films Ltd	SAIF II Mauritius Co Ltd	AC-Apr-Sep. 2006	6.66
JK Paper Ltd	International Finance Corp	R-Apr-Sep.2006	9.84
Jubilant Organosys Ltd	GA European Investments Ltd	AC-Jul.2005	7.93
KPR Mill Ltd	Ares Investments	R-Feb.2007	6.78
Punj Lloyd Ltd	Merlion India Fund III Ltd	R-Dec.2005	3.19
Sarda Energy & Minerals Ltd	LB India Holdings Mauritius Ii Ltd	R-Mar.2008	7.73
Torrent Pharmaceuticals Ltd	GPC Mauritius	AC-Oct.2007 & AC-Jan.2008	4.83
Yes Bank Ltd	Orient Global Tamrind Fund Pte Ltd	R-Apr.2008	4.95

Source: Company-wise details of FDI inflows reported in the SIA Newsletter, various issues. The Shares in equity capital of the respective companies shown in column (4) are taken from the Bombay Stock Exchange website.

In Column (3) 'R' indicates that the inflow was through the Automatic Route and 'AC' indicates the Acquisition of existing shares by the foreign investor.

Table 18

Illustrative List of Reported Inflows which do not Qualify as FDI

Indian Company	*Foreign Investor*	*Reporting Month #*	*Inflow (₹ Cr.)*
(1)	*(2)*	*(3)*	*(4)*
Akruti Nirman Ltd	Various	Apr.2007	155.34
Arshhiya Technologies	Various FIIs	May2008	350.00
Bajaj Auto Finance Ltd	Various	Oct.2007	157.50
Bajaj Auto Finance Ltd	Various NRIs	Dec.2007	126.48
Bharat Earth Movers Ltd	42 FIIs	Jan.2008	147.15
Gitanjali Gems Ltd	Various NRIs/FIIs	Nov.2007	109.11
Hindalco Industries Ltd	Various	Feb.2008	666.58
Hindustan Oil Exploration Co Ltd	Various NRIs/FIIs	Sep.2008	220.36
Housing Development & Infrastructure Ltd	Various	May2008	706.67
IRB Infrastructure Developers Ltd	Various IPO	Sep.2008	476.61
Kotak Mahindra Bank Ltd	Various	Feb.2008	1,615.00
Mahindra & Mahindra Ltd	Various FFI,FC, FFI	ApSep.2006	260.63
Mahindra Gesco Developers Ltd	Various	Jun.2007	324.08
Mercator Lines Ltd	Various FIIs	May2008	196.97
Mercator Lines Ltd	Various NRIs	May2008	21.56
Mundra Port and SEZ Ltd	Various NRIs/FIIs	Feb.2008	710.57
Panacea Biotec Ltd	As Per List Attached	Nov.2006	118.31
Panacea Biotec Ltd	As Per List	Nov.2006	101.59
Phoenix Mills Ltd	Various FIIs	Dec.2007	317.72
Reliance Communications Ltd	Various FIIs	May2008	845.48
Sterlite Industries Ltd	Various NRIs	Oct.2007	1,667.64
Tata Consultancy Services Ltd	Group of Non-Resident	Mar.2006	2,148.61
Tech Mahindra Ltd	Various	Jul.2007	171.97
Welspun Gujarat Stahl Rohren Ltd	Various FIIs	Feb.2008	302.15
Zee Telefilms Ltd	Various Investors	Apr.2008	152.49

Source: Company-wise details of FDI inflows reported in the *SIA Newsletter*, various issues.
All these inflows were through the Automatic Route.

Table 19

Reported FDI Inflows on account of Home Sweet Home Developers Ltd.

Name of the Foreign Investor	*Inflow (₹ mn)*		*Name of the Foreign Investor*	*Inflow (₹ mn)*
Archana Vadya	0.01		Satya Kavachri	0.01
Ashish Srivastava	0.01		Satya Simha Prasad	0.01
Baiju Anand G Nair	0.01		Senthil Palanisamy	0.01
Brajesh Goyal	0.01		Shiddalingnagouda Rati	0.01
C.Sivanandan	0.01		Srikanth Patibanda	0.01
Devi Prasad Ivaturi	0.01		Srikumar Gopakumar	0.01

Name of the Foreign Investor	*Inflow (₹ mn)*		*Name of the Foreign Investor*	*Inflow (₹ mn)*
Eswar Vemulapalli	0.01		Srinivasu Sudireddi	0.01
Jayakrishnan Radhakrishnan	0.01		Srinvasa R Gaddamadugu	0.01
Krishna Kumar Vavilala	0.01		Sukir Kumaresan	0.01
Lakkoji	0.01		Venkateshwarlu Ravikant	0.01
Leela Prasad Koneru	0.01		Vijaya Kumar Christopher	0.01
Nakkapalli Veera Sekhar Babu	0.01		41 Non Resident Indians	0.21
Nirupama Henjarappa	0.01		Six NRI's One share each	0.03
Pradeep Shantaram Bhat	0.01		Six NRIs 1 share each	0.03
Raghu Bharadvaj	0.01		Ravi Kanth V.	0.01
Rama Murthy Setty	0.01		Suman Vijayagopal	0.01
Ramesh Babu Doddi	0.01		1.Srivamsi Madhwapthy 2.Ravi Mikkilineni	0.01
Ramesh Babu Vusirikala	0.01		Padmanabha C.J.	0.01
Ranganatha Bande	0.01		Raju Nunna	0.01
Sangeeth Omanama	0.01		Ramesh Racheria	0.01

Source: Inflow details reported in the SIA Newsletter, various issues of 2006.

market, even that contribution cannot be counted upon). In fact, assuming that PE/VC/HF investors would exercise management control an appropriate question to ask would be whether one could distinguish between such domestic and foreign investors in terms of their management inputs and contribution to the performance of the domestic company. Interestingly, Hymer pointed out that such foreign investors seek control over the enterprise in order to ensure the safety of his investment and that the "reason applies to domestic investment as well". These are the cases that fall under Hymer's Type 1 FDI category. In fact, it might not be possible to distinguish domestic and foreign financial investors especially when the latter are promoted by locals after gaining considerable experience in similar businesses abroad. For instance, a perusal of senior management (including Indians) and other Indians working with General Atlantic, a leading global investment firm, reveals that most of these have commonality in terms of the business schools they attended and past employment with consultancy/investment firms. (Annexure D) This is also true when operations in the host country are handled by locals with foreign investors exercising control but not strategy.[77] Then there are Indian companies which float offshore companies and bring back the funds raised abroad as FDI. It is evident that analysis of FDI companies' operations based on the sole 10%

[77] It is even said that "Whereas an Indian-based private equity firm is more likely to understand the particular dynamics affecting an Indian company, US-based firms often mistakenly approach investment opportunities with a belief that a model that works in the US will transpose successfully to India. It can be difficult for them to get the balance right between introducing best practice and discarding what is irrelevant and possibly even damaging for Indian companies." See: "Private Equity in India: An Executive Round Table" at http://content.spencerstuart.com/sswebsite/pdf/lib/PrivateEquityIndia_2007_web2.pdf (Accessed on May 18, 2010).

foreign equity criterion is likely to come out with erroneous results. Added to such financial investors, if companies in which Indians themselves hold shares and control enter as FDI investors, there will be very little justification for classifying such investment as FDI. As has been mentioned earlier, such cases appearing among the 2,748 inflows have been treated as round-tripping ones by us. (Table 21) An analysis which treats such companies as FDI companies could obviously end up projecting a misleading picture.

Table 20
Companies which could be Classified as FDI Companies by the 10% Criterion

Name of the Indian Company	*Name of the Foreign Investor holding 10% or more in Equity*	*Share in Equity (%)*
(1)	*(2)*	*(3)*
Apollo Hospitals Enterprises Ltd	Apax Mauritius FDI One Ltd, a PE Company	11.41
Binani Cement Ltd	JP Morgan Special Situations Mauritius Ltd	11.59
Hindustan Sanitaryware & Inds. Ltd	HPC Mauritius Ltd, investment management co.	14.99
Infotech Enterprises Ltd	GA Global Investments Ltd, investment management Co.	12.86
IOL Chemicals & Pharmaceuticals Ltd	India Star Mauritius Ltd, a PE Company	14.80
Kanoria Chemicals & Industries Ltd	International Finance Corp (IFC), World Bank's private sector investment arm	10.84
Max India Ltd	Parkville Holdings Ltd, a Warburg Pincus co.	12.83
Modern Dairies Ltd	International Finance Corp (IFC) , World Bank's private sector investment arm	19.90
Moser Baer India Ltd	Woodgreen Investments Ltd, Warburg Pincus co.	13.10
Shriram EPC Ltd	Bessemer Venture Partners Trust	23.84
Spanco Telesystems and Solutions Ltd	Monet Ltd., s/o ChrysCapital, a PE	14.92
Varun Shipping Co Ltd	Caledonia Investments Plc, an investment trust	11.16
Alfa Transformers Ltd	Strategic Venture Fund Mauritius, Venture Fund	14.93

Source: Based on the shareholding patterns as on September 30, 2010, available at the Bombay Stock Exchange website http://www.bseindia.com.

It is evident that one can place far more reliance on RBI's FCRC studies which followed stricter criteria than on those based on the broader FDI criterion. At one point of time in the past, the Research & Statistics Division of the then Department of Company Affairs used to bring out Factsheets on Foreign Subsidiaries and Branches in India. Unfortunately, while there is far more emphasis on attracting FDI in India now, reliable and representative data sources on FDI company operations have not developed commensurately. In fact, one could affirm that there has been marked deterioration. Even the Research & Statistics division has stopped bringing out Factsheets on Foreign Branches and Foreign Subsidiaries, not to speak of those Indian non-government companies with a minimum of paid-up capital. The emphasis has been on relaxing policies and improving procedures.

Table 21
Companies which could be Classified as FDI Companies by the 10% Criterion and where the Companies are Constituents of Some Indian Promoter Groups

Indian Company	*Foreign Promoter*	*Share in Equity (%)*
(1)	*(2)*	*(3)*
Sterlite Industries India Ltd	Twinstar Holdings Ltd	56.98
Madras Aluminium Co. Ltd	Twinstar Holdings Ltd.	80.00
Zee Entertainment Enterprises Ltd	Delgrada Ltd	17.20
Essar Shipping Ports & Logistics Ltd	Teletech Investments India Ltd	20.56
United Breweries Holdings Ltd	Watson Ltd	21.19
Essel Propack Ltd	Lazarus Investments Ltd	10.90
Rama Phosphates Ltd	NRI Investors Inc	31.86
Exide Industries Ltd	Chloride Eastern Ltd	48.87
Zensar Technologies Ltd.	Pedriano Investments Ltd	21.55
Punj Lloyd Ltd	Cawdor Enterprises Ltd	24.94
Patni Computer Systems Ltd	iSolutions Inc	14.25
Ispat Industries Ltd	Ispat Steel Holdings Ltd	17.00
HCL Technologies Ltd	HCL Holdings Pvt Ltd	18.26

Source: Based on the shareholding patterns as on September 30, 2010, available at the Bombay Stock Exchange website http://www.bseindia.com.

3.4 Private Equity and Venture Capital

In view of the important place of PE/VC/HFs in the reported FDI inflows it would be in order to pay specific attention to their characteristics keeping in view the expectations from such investments in general and from foreign companies in particular. While there is no systematic reporting of PE/VC/HF investments by the government, some private agencies collect data from various sources and bring out reports periodically to give their own assessment of the situation. Observations based on such studies would always have classification and coverage problems and have to be interpreted with caution. Nevertheless, we shall present a few impressions emerging out of the available data and information.

It appears that globally private equity investments have been shifting to emerging markets. Though their share fluctuated, it increased from about 4% in 2001 to the peak of 22.20% in 2009. The reported amounts were $ 1.93 bn in 2001 and $ 7.20 bn in 2004. Thereafter the investments increased rapidly to $ 53.14 bn in 2007. In the subsequent two years, the amount fell to reach $ 22.10 bn in 2009. The share of BRICs (including South Africa) within the emerging markets remained about half. Within BRICs, India's position improved *vis-a-*

vis China till 2007 when it managed to overtake China, though it fell behind China in the subsequent two years.[78] The Working Group on Foreign Investment also acknowledged this when it said: "FDI inflows began in the early 1990s and have gathered momentum, particularly after India became important to global private equity funds."[79]

Though precise break-up between foreign and local PE/VC/HF investors is not available, it does appear that foreign funds dominate the PE/VC/HF scene in India. For instance, according to SEBI, at the end of December 2009, against the total investments of ₹26,827 crore by Foreign Venture Capital Investors (FVCIs) registered with it, investments by Indian Venture Capital Funds (VCFs) was of the order of ₹15,232 crore.[80] A closer examination of the list of registered FVCIs, however, suggests that some of the FVCIs were indeed promoted by Indian financial institutions like the ICICI, IDFC, UTI and IL&FS.[81] (Table 22) In view of this, not all FVCIs can be expected to exhibit the characteristics of a foreign venture capital. Yet another aspect to the registered FVCIs, relevant in the overall context of this study is that out of the 144 FVCIs as many as 140 were based in Mauritius (including the ones related to Indian institutions; expectedly most of these (once again including those promoted by the Indian institutions) are located at just a few addresses), two in Cyprus and the remaining two in Singapore. Another dimension to the domestic VCFs is that some of these belong to Indian large business group and financial institutions. Composition of top management and investment advisers of some of the registered VCs suggests that it is difficult to classify them either as Indian or foreign.[82]

From probably a more systematic study of the sector (foreign and domestic funds together) in India, we find that Manufacturing was not the favoured area for PE/VC investment as telecom & media, engineering & construction and financial services claimed increasingly larger shares.[83] (Annexure E) Companies which are in their late stage of development or which are already listed on the stock exchanges were the most

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78 EMPEA Industry Statistics & PitchDeck available at http://www.empea.net/Main-Menu-Category/Resource-Library/EMPEA-Industry-Statistics-PitchDeck-1H-2010-ppt--Public.aspx

79 Ministry of Finance, *Report of the Working Group on Foreign Investment*, 30 July 2010, p. 45.

80 Excluding the ₹9,661 crore investment foreign FVCIs in Indian VCFs.

81 "We're getting enquiries from several investment managers now. The idea of setting up offshore funds is fast catching among Indian asset management companies," said Chetan Nagendra, head of India practice, Harneys Westwood & Riegels, a firm that services clients setting up businesses in British Virgin Islands (BVI) and Cayman Islands. See: "Indian mutual funds approach zero tax destinations to raise offshore capital" at http://economictimes.indiatimes.com/articleshow/5582011.cms?prtpage=1 (last accessed on May 24, 2010). Also relevant here are the observations of Bain & Co cited in Section II.

82 E.g. Helio Venture Partners India LLC, Mauritius FIRE Capital Fund, Nexus India and NEA Indo-US Ventures. Confusion of a similar kind is unavoidable when going though the Ernst & Young's joint publication with Outlook Business magazine—"Private Equity in Numbers", December 2008.

83 Thillai Rajan A and Ashish Deshmukh, *On Top of the World; Still Miles to Soar*, India Venture Capital and Private Equity Report, Indian Institute of Technology Madras, 2009. By many indications it was the real estate sector that the funds including VCs were targeting. Relaxation of FDI policy and encouragement to SEZs gave a boost to this phenomenon.

Table 22
Illustrative Cases of Overlapping of Domestic and Foreign Venture Capital Investors Registered with SEBI

Foreign Venture Capital Investor(s)	*Corresponding Domestic Venture Capital Fund(s)*
(1)	*(2)*
2i Capital PCC	Indian Enterprise Fund
AIF III Sub Pvt. Ltd (sponsored by UTI)	UTI - India Technology Venture unit scheme
Aureos Offshore India Opportunities Fund, LLC Aureos South Asia Fund LLC	Aureos India Fund
Avigo venture Investments Ltd	Avigo India Private Equity Trust
BTS India Private Equity Fund Ltd	BTS India Private Equity Fund
Footprint Ventures (Mauritius), Ltd	Footprint Venture India Fund
IDFC Private Equity (Mauritius) Fund II IDFC Private Equity (Mauritius) Fund III IDFC Project Equity Company II (Mauritius) Ltd IDFC Project Equity Company IV (Mauritius) Ltd	IDFC - India Infrastructure Fund - 3 IDFC Infrastructure Fund IDFC Infrastructure Fund - 2
Dynamic India Fund 1 Dynamic India Fund III Dynamic India Fund V Dynamic India Fund IV (ICICI Real Estate Fund)	India Advantage Fund 1 India Advantage Fund -III India Advantage Fund IV India Advantage Fund V India Advantage Fund VIII ICICI Econet Fund ICICI Emerging Sector Trust
India Leverage Fund LLC	IL&FS ORIX Trust IL&FS Private Equity Trust
JM Financial - Old Lane India Corporate Opportunities II Ltd (previously known as JM Financial India II Ltd)	JM Financial India Fund JM Financial Property Fund
KSK Emerging India Energy Pvt Ltd - I	Small is Beautiful
SEAF India International Growth Fund	SEAF India Investment Trust
Ventureast Biotech Fund	Ventureeast Telnet India Fund
Zephyr - Peacock India I	Zephyr Peacock India II Trust

Source: Selected from the lists available at the SEBI website http://www.sebi.gov.in.

preferred recipients. In this, the study also found that while majority of early stage investments are contributed by domestic investors, a large share of PIPE[84] and buyout investments are funded by foreign investors, suggesting the tendency of foreign investors to invest in established businesses.[85] Further, it was noticed that as many as 75% growth stage investments exited in less than 2 years underlying the short-term nature of PE/VC investments in India. PE/VC investments in India were indeed put

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[84] PIPE stands for Private Investment in Public Equity *i.e.*, in already stock exchange listed companies.
[85] This analysis suffers from serious classification issues.

under the category of 'quick flips'.[86] A recent study noted that an overwhelming proportion of PE/VC fund managers have experience in financial management thereby further underlining their financial investment nature in India.[87] It is evident that India's experience with PE/VC investments does not support the traditional view for such investments and it is highly unlikely that India would be able to derive the benefits associated with such investments unless there is a drastic change in their approach. It is, therefore, further justified to term them as portfolio investments instead of treating them as FDI merely because the respective investors happen to hold the minimum qualifying equity level of 10%. Further, given the manner in which private equity funds are floated and run, to which venture capital belongs to, one wonders in what way 'foreign' venture capital differs from domestic private venture capital and why should the former be preferred to the latter.

In any case, it is extremely relevant to note that Round-tripping related PE/VC/HF investments and Round-tripping as such gained in importance in the total inflows while the other PE/VC/HF investments declined relatively in line with international experience. (Table 23 and Chart 9). It can be seen further that it is the portfolio investments comprising of PE/VC/HF, NRIs and Other Portfolio types which declined sharply in 2009 while there was only a slight dip in what can be termed as realistic FDI inflows. In contrast, total Round-tripped investments registered a marginal increase. (Table 24 and Chart 10). Instead of the aggregates, an analysis of the individual inflows could thus throw better light on the factors/investors that are responsible for the slowdown during 2010.

Table 23
Growing Importance of Round-tripping Inflows

Year	*Share in Total of 2,748 Inflows (%)*			
	PE/VC/HF Only	*Round-tripped PE/VC/HF*	*Round-tripping Only*	*Total Round-tripping Cols. (3) + (4)*
(1)	*(2)*	*(3)*	*(4)*	*(5)*
2004 (Sep-Dec.)	29.83	0.00	1.68	1.68
2005	15.96	1.92	1.38	3.30
2006	20.94	2.81	1.28	4.10
2007	34.87	2.88	9.19	12.07
2008	23.20	3.72	11.48	15.19
2009	16.67	6.09	14.94	21.03
Total	22.90	4.02	10.30	14.32

[86] A. Thillai Rajan, "A Life-Cycle Analysis of VC-PE Investments in India", *The Journal of Private Equity*, Winter 2010, Vol. 14, No. 1, pp. 72-82.

[87] A. Thillai Rajan and Vishal Kamat, "India Venture Capital and Private Equity Report 2010: Contours of Smart Capital", Indian Institute of Technology, Madras,

Chart 9

Share of Different Categories of Foreign Investors in Inflows during 2009

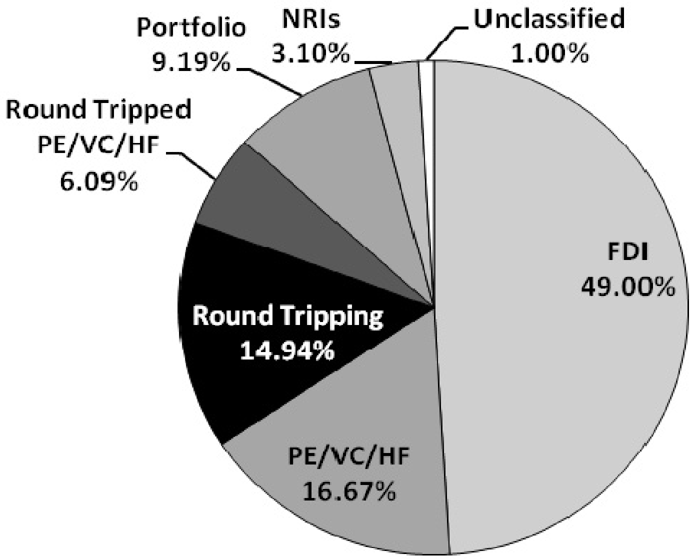


Table 24

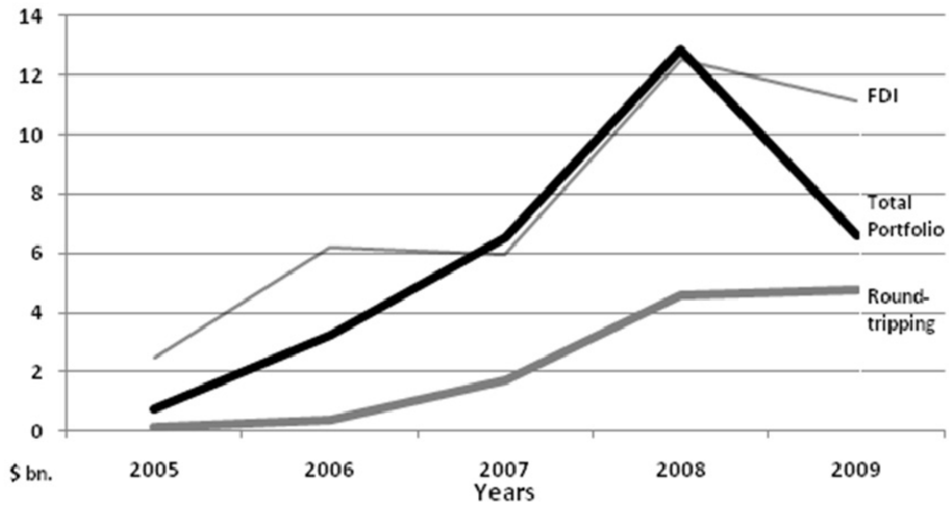
Year-wise FDI Equity Inflows According to the Type of Investor

in $ mn

	Type of Investor	*2005*	*2006*	*2007*	*2008*	*2009*
	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*
1	FDI	2,482	6,184	5,962	12,526	11,154
2	PE/VC/HF	540	2,056	4,947	6,959	3,796
3	Portfolio	209	625	785	3,738	2,093
4	NRI	17	536	770	2,167	706
	Sub-Total (2+3+4)	*766*	*3,217*	*6,502*	*12,864*	*6,595*
5	Round-tripping	47	126	1,304	3,443	3,400
6	Round-tripped PE/VC/HF	65	276	409	1,115	1,387
	Sub-Total (5+6)	*112*	*402*	*1,713*	*4,558*	*4,787*
7	Unclassified	24	17	8	50	228
	Grand Total	3,384	9,820	14,186	29,996	22,764

Source: See Table 9.

Chart 10
Differing Behaviour of FDI, Portfolio and Round-tripping Investments in 2009



4. Summary and Concluding Observations

The new economic policy regime in India, which came into being in mid-1991, emphasised the role that foreign capital can play in furthering the country's development aspirations, in particular her industrialisation needs. In so doing, a two-pronged strategy was adopted: one to attract FDI which is seen, in addition to capital, as a bundle of assets like technology, skills, management techniques, access to foreign markets, etc; and two, to encourage portfolio capital flows which help develop capital markets and ease the financing constraints of Indian enterprises. The FDI policy was liberalised gradually in terms of the eligible sectors, extent of foreign participation and the need for case-by-case approvals. The expectations from the two types of flows were quite different.

After a slow and gradual rise till the middle of 2000s, inflows increased rapidly thereafter. From an average of just $ 1.72 bn. during 1991-92 to 1999-00, and the slightly higher $ 2.85 bn. during 2000-01 to 2004-05, the equity inflows surged to $ 19.78 bn. during 2005-06 to 2009-10. Viewed in the context of considerable discussion and concern regarding FDI inflows not matching India's potential and being far lower than the initial expectations, the surge since the mid-2000s did succeed in projecting the picture of growing confidence in India of international investors. Recent data, however, suggests that inflows during 2010-11 would be substantially lower than that in 2009-10. A detailed analysis of the FDI inflows is the subject matter of the present study. In the process of analysing the characteristics of the increased inflows, the study underlined the ambiguities in the measurement of FDI, especially the choice of 10% as being sufficient condition to represent control and lasting interest, propriety of treating certain categories of investments as FDI (the consequence of which being the blurring of boundaries between direct and portfolio investments) and adherence to the accepted international norms by the Indian official agencies. It also raised the possibility of reported acquisition of shares underestimating the extent of takeover of Indian businesses by foreign companies.

Aggregate data suggest that a major contributor to the recent increase has been reinvested capital (which is being estimated since 2000-01 following India's decision to adopt international practices in reporting FDI data) which does not represent fresh inflows. Another important component is the inflows through the acquisition route. While the former does not represent fresh inflows, the latter generally does not add to the existing production or services capabilities. Official data also suggest that there has been a perceptible shift in the sectoral composition of inflows with the growing dominance of non-manufacturing sectors. Increasing proportion of inflows being routed through tax shelters implies considerable revenue loss to the exchequer. Characteristics of the global FDI flows suggest that India's experience with FDI inflows is not specific to her. For instance, according to UNCTAD *World Investment Reports*, the share of Manufacturing sector in world FDI flows declined from 34.23% to 24.01% between 1989-1991 and 2005-2007.[88] The corresponding decline for developing economies was from 46.54% to 31.00%. One the other hand, the share of services increased from 50.45% to 58.95% for the world, whereas for developing countries the increase was from 30.78% to 56.68%. Within services the financial sector has acquired an important place in the latter period: from 17.74% to 21.37%. In case of developing countries, the increase was far sharper: from 6.31% to 19.31%. It is also acknowledged that private equity plays a major role in global FDI flows, especially in those involving M&As.

While these broad features of inflows are somewhat well-known, questions are occasionally raised about the nature of FDI flows in India which might not be strictly equated with direct investment and which may not be able to deliver the expected benefits. Keeping this and the widely accepted definition of FDI in view, the study analysed the officially reported largest 2,748 cases of FDI Equity inflows, each individually accounting for at least $ 5 mn during September 2004 to December 2009, the period during which inflows recorded a sharp increase. The 2,748 inflows are fairly representative in value terms of the total equity inflows through the FIPB/SIA, Acquisition and Automatic routes as they accounted for about 88% of the total for the period. A distinctive feature of this exercise, which to the best of our knowledge has not been attempted so far, is the classification of the foreign investors with a view to assess the flows from the point of their meeting the criteria and expectations from FDI. It has been quite a challenging task which has never left one satisfied because of many information gaps. Notwithstanding these limitations, we do hope that the exercise would

[88] UNCTAD, *World Investment Report*, 2009. World includes South-East Europe and CIS.

help take the understanding of FDI further not only in India but even in the international context. Some of the key findings of this exercise are as follows.

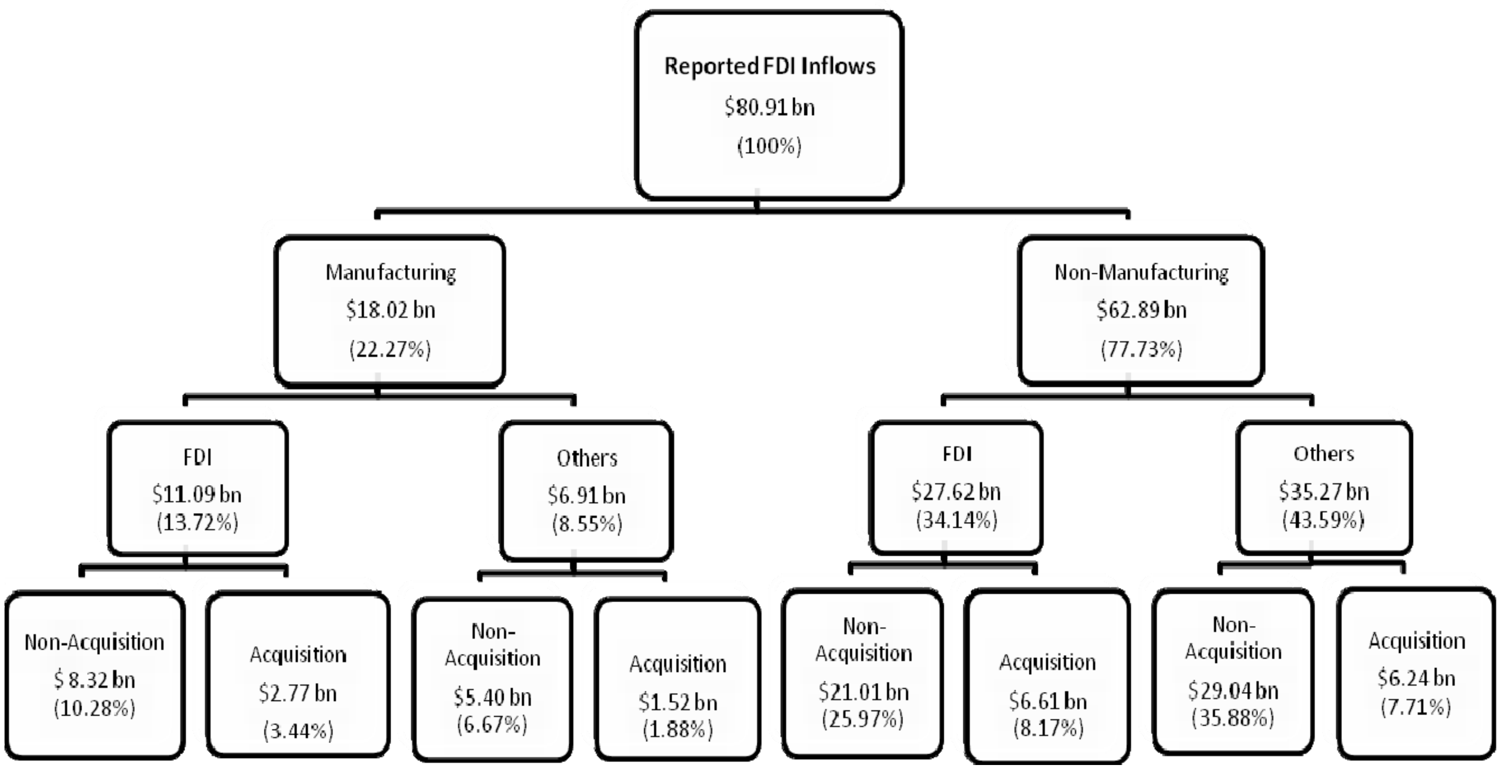
Going by the basic premise of FDI and identifying the foreign investors who also operate in the same sectors in their home countries and thus could *(i)* be long term players and *(ii)* bring in not only capital but also the associated benefits on their own strength, we found that only a little less than half of the inflows could be realistically categorised as FDI. We have specifically kept out the private equity investors and other portfolio investors as well as inflows under control of Indians/Indian companies (termed as Round-tripping investment) from the realistic FDI category. The next most important category of investments is by PE/VC/HF investors followed by Round-tripping investment and other Portfolio investors in that order. There is a degree of overlap between PE/VC/HF investments and Round-tripping. It is quite relevant to note that Round-tripping related investments increased gradually during the period from just a little less than 2% in 2004 to 21% in 2009. While the share of PE/VC/HF not related to Round-tripping declined from the peak of 34.87% reached in 2007 (in line with the international experience), the share of Round-tripping related PE/VC/HF increased gradually.

The share of realistic FDI in total inflows into the Manufacturing sector is relatively higher at about 62%. It was the highest in case of Telecommunications. On the other hand, it was the least in case of the Construction & Real Estate sector and Other Infrastructure, thereby implying that there was not much that the foreign investor brought in as proprietary knowledge into these sectors. Realistic FDI that could add to the existing manufacturing facilities, the main focus of the Statement on Industrial Policy of July 1991, formed only a small proportion of the total reported inflows. In general, non-acquisition type realistic FDI accounted for 36% of the total inflows of $81 bn. covered by the 2,748 cases and that going into Manufacturing sector formed a mere 10% of the total. (See Diagram).

Only a small proportion of the total inflows are subjected to specific government approvals. Interestingly, compared to the other investors, specific approval from the government (FIPB/SIA) was sought to the maximum extent by what we termed as realistic FDI investors. Nearly all of NRIs' investment is through the Automatic Route. More importantly, more than 90% of the inflows under the Round-tripping and PE/VC/HF categories of investors are entering without the need for case-by-case approvals just like FII investments which do not require specific approval once they are registered with the Indian regulatory authorities.

In case of India while it is typical of the FDI inflows to enter via tax havens, this route is exploited the most by PE/VC/HF and Round-tripping variety of inflows. This is more so by PE/VC/HFs promoted by Indians. Most of the investments by Telecom and IT&ITES investors followed by those in Construction & Real Estate sector passed though such countries. Interestingly, about 90% of such investments in the Construction & Real Estate

Diagram
Composition of the reported Top 2,748 FDI Inflows



Figures in parentheses are percentages are calculated with respect to total Reported Inflows.

sector were routed through the tax havens and benefited from the automatic entry facility. While one would not say foreign PE/VC/HF investments are wholly unwelcome, it can be said that those investments that do not match the expectations from FDI need to be viewed differently. Since such financial investors seek higher and quicker gains and their preferred sector of investment is prone to speculative expectations,[89] net addition to domestic investible resources on their account could also not be guaranteed even in the medium term. On top of that, the tax haven route that they have exploited for entry into India ensures that the exchequer would not gain much from the profits they earn. Thus, inflows that cannot be characterised as FDI not only have had a relatively easy passage but they had also exploited the tax haven route to much greater extent.

4.1 Measurement and Classification (Direct or Portfolio?)

An inescapable conclusion, notwithstanding the status accorded to such investments by the international agencies and adopted across nations, is that a good part of the FDI flowing into India is closer to portfolio investment than to FDI having 'long term interest' and a 'bundle' of attributes. Then there is also the increasing share claimed by Round-tripping investments. Worse still, some part of the inflows to India does not qualify as FDI even going by the 10% criterion. What seems to be happening in practice is that *all* equity investments which are not coming through the foreign institutional investor (FII) route are being treated as FDI *irrespective* of the proportion of shares held abroad and the extent of influence of the foreign investor.[90] This becomes amply clear from the Draft Press Note on FDI Regulatory Framework. Interestingly, even important official advisory bodies appear to be unaware of how the FDI data were being compiled. The FDI figures made up in the above manner may help India project a healthy picture of inflows but these do not ensure the expected benefits no better than ADRs/GDRs which are treated as portfolio capital and external commercial borrowings. Indeed, given the possibility that institutional investors who invest in companies listed on the Indian stock exchanges as FIIs, subscribe to ADR/GDRs as also invest in India-focussed companies on the London Stock Exchange, the inflows on account of the latter could also be seen as another form of foreign portfolio capital.[91]

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89 Indeed, the government had imposed a three-year lock-in for FDI in the real estate sector.

90 Incidentally, it is reported that DIPP had clarified that FIIs cannot take more than 10% equity and that they "will have to follow the rules applicable to portfolio investors even if they are investing through the foreign direct investment route".
See: "FIIs taking FDI route face 10% stake cap in local co" at http://economictimes.indiatimes.com/articleshow/5814523.cms?prtpage=1

91 Interestingly, the Working Group on Foreign Investment suggested a new category of portfolio investors namely, 'Qualified Foreign Investors' which would subsume FIIs, FVCI and NRI investments. The Working Group also recommended that "(W)ithin the automatic route, there would be no distinction between FDI and portfolio investment". Ministry of Finance, *Report of the Working Group on Foreign Investment*, 30 July 2010, p. 77.

It is evident that at the global level the 10% criterion is being used as a thumb rule and even investments which are unlikely to exhibit the characteristics of typical FDI are being categorised as such for BOP measurement purposes. That the 10% criteria is adopted mainly because of the stated objective of ensuring comparability across nations, and that a suggestion to raise the limit to 20% in accordance with the International Accounting Standards was summarily rejected makes the limit even more open to question. As a result, various forms of financial investments which one finds difficult to unquestionably treat as FDI are being considered as such. There is also the question of their potential impact on the host countries about which not much is known. These are not miniscule in size as they account for a sizeable portion of global FDI flows. Notwithstanding the fact that such investments are accompanied by control/influence as well, their investments cannot be distinguished from typical financial investors. Unlike typical FDI, private equity investments come with a pre-conceived idea of exiting the venture after certain duration[92]. They do not own any proprietary technology and hence the investee enterprises may only be directed to the appropriate sources. Private equity and other portfolio investments do not fall under the standard motives of resource seeking, efficiency seeking, market seeking and strategic asset seeking FDI. They may, if necessary, be categorised as pure return seeking FDI. Given the manner in which the sector proliferated, those who promote and run the PE firms are more like global consultants who work for a fee. These include persons of Indian origin/nationality many of whom cannot be distinguished from foreigners in terms of education, training and experience. Except for the fact that capital flows from another country, one does not find anything related to nationality about them.

India's experience with PE/VC investments suggests that their preference for established companies and the Construction & Real Estate sector on the one hand and the 'quick flips' nature on the other make their contribution questionable.[93] The way domestic investors floated PE firms abroad (and possibly raised money abroad genuinely[94]), some of the registered domestic venture capital companies having strong foreign affiliation and many large Indian business groups and banks entering private equity business, the distinction between 'domestic' and 'foreign' has got even further blurred. In the choice of

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92 For a description of private equity, see: Kavaljit Singh, *Fixing Global Finance*, Madhyam, Delhi and SOMO, Amsterdam, 2010.

93 In fact to contain the real estate bubble, to which these funds also contributed, India had to raise interest rates.

94 It may not always be easy to find out on whose behalf the funds have invested. For instance, Rudolf Elmer, a former employee of Julius Baer, a Swiss bank, who has passed on the details of about 2000 of the bank's account holders to Wikileaks explained the modus operandi as:

> You are an Indian client and you want to have money in Julius Baer. You have good relationship with a relationship manager who makes investments. The banker sets up a fund in the Cayman Islands and asks his client to invest in that mutual fund. The relationship manager makes the decision to buy the fund and make investments in India for the client…

See: "Leaks Reveal Cayman Black Money Trail", *Mail Today*, January 19, 2011.

tax havens too, both have something in common. In the end, the FDI route has also become a conduit for domestic entrepreneurs to avoid taxes and worse still in some cases going by the multi-layering adopted by them raise serious doubts about the origin of the funds.[95] The differences in the behaviour of realistic FDI, all Portfolio investors (excluding Round-tripping) and Round-tripping came out sharply in 2009. While realistic FDI declined marginally, portfolio investments fell sharply. On the other hand, Round-tripping investments increased slightly.

In 2003, while deciding on the *Azadi Bachao Andolan* petition, the Supreme Court justified the tax advantage offered to foreign investors coming through the tax havens like Mauritius in the following manner:

> There are many principles in fiscal economy *which, though at first blush might appear to be evil, are tolerated in a developing economy*, in the interest of long-term development. Deficit financing, for example, is one; treaty shopping, in our view, is another. Despite the sound and fury of the respondents over the so-called "abuse" of "treaty shopping", perhaps, it may have been intended at the time when the Indo-Mauritius DTAC was entered into. *Whether it should continue, and, if so, for how long, is a matter which is best left to the discretion of the executive as it is dependent upon several economic and political considerations.* This court cannot judge the legality of treaty shopping merely because one section of thought considers it improper.[96]

In early 2010, the Authority for Advance Rulings (Income Tax) New Delhi, while upholding the foreign investor's claim of non-liability of Tax on the sale of shares held by E'Trade Mauritius Ltd in an Indian company, said:

> Though it looks odd that the Indian tax authorities are not in a position to levy the capital gains tax on the transfer of shares in an Indian company, this is an inevitable effect of the peculiar provision in India-Mauritius DTAA, the Circular issued by CBDT and the law laid down by Supreme Court in Azadi Bachao case. *Whether the policy considerations underlying the crucial Treaty provisions and the spirit of the Circular issued by the CBDT would still be relevant and expedient in the present day fiscal scenario is a debatable point and it is not for us to express any view in this behalf.* (emphasis added).[97]

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[95] See for instance: "ED traces key suspect's 2G money trail to Cyprus, Libya, Mauritius", at http://timesofindia.indiatimes.com/india/ED-traces-key-suspects-2G-money-trail-to-Cyprus-Libya-Mauritius/articleshow/7080911.cms; "Raids reveal Mittal-linked co got huge foreign inflows" at http://timesofindia.indiatimes.com/india/Raids-reveal-Mittal-linked-co-got-huge-foreign-inflows-/articleshow/6868740.cm; and "2G scam: ED questions Unitech on fund transfers" at http://timesofindia.indiatimes.com/india/2G-scam-ED-questions-Unitech-on-fund-transfers/articleshow/6940321.cms

[96] Authority for Advance Rulings (AAR) No.826 of 2009, dated March 22 2010 available at http://rulings.co.in/it-rulings/uploads/pdf/1269340941_etrade.pdf. DTAC stands for Double Tax Avoidance Convention.

[97] *ibid.*

Earlier, the Comptroller and Auditor General of India in its report on direct taxes *System Appraisals* for the year 2003-04 emphasised that:

> ... a holistic study of DTAAs be conducted to ascertain the benefits accruing to the nation, especially as these are not placed before Parliament. A well-designed and periodical cost benefit analysis would also need to be put in place.
>
> Shortcomings in DTAAs, especially those relating to definition and operation of permanent establishment, limitation of treaty benefits and disallowing treaty shopping needed to be removed so as to curtail misplaced incentives and ensure that the benefits of DTAAs are availed by bonafide assessees.[98]

In view of the evidence proffered above and press reports indicating the deployment of tax havens by Indians themselves, there is a need to rethink on the issue, especially since the economic conditions to which the Supreme Court alluded to do not exist any longer and even the world at large has recognised the need to restrict the abuse of tax havens.[99] Should this facility, which works as a tax incentive, be extended to all sectors and all types of investors? Instead, can such tax incentives be offered directly to both domestic and foreign investors in selected sectors?

Portfolio investment which does not come through the stock market may not be as volatile as that which comes through it. The recent crisis has, however, shown that the former could be less reliable as the flows, even if they cannot be withdrawn, can dwindle and affect the economies which rely on them to meet the current account gap. On the other hand, there is nothing which suggests that such investments by themselves enhance the capabilities of investee companies to contribute to bridge the current account gap. Taking advantage of the liberal FDI definition, which does not distinguish between the nature of the investor, portfolio investors may adopt the FDI route more in the event of capital controls being introduced on portfolio investments.

As has been mentioned earlier, the RBI is now concerned about the fall in FDI inflows during the current financial year (2010-11) in the context of higher level of current account deficit and dominance of volatile portfolio capital flows. Besides the environmentally sensitive policies pursued, it identified the sectors responsible for the slow down as “construction, real estate, business and financial services”.[100] It is evident

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98 Comptroller and Auditor General of India, *Report No. 13 of 2005, Direct Taxes*. See the relevant chapter of the report available at http://saiindia.gov.in/cag/file/overview-310.

99 Apart from the controversies surrounding the financing of IPL franchisees and the leaked contents of ‘Radia tapes’ and investigations, we did come across, in this study, companies funded by an alleged arms dealer. Interestingly, press reports also corroborate this observation. For instance, the *Times of India* suggests that the person concerned was an accused in several cases filed by the CBI for manipulation and bribery in defence purchases and that he was not seen in India since 2006. The paper also reveals that “In India too, the family has several companies, to which investments have come from firms in tax havens”. See: “Arms dealer wanted in India major funder of UK Liberal Democrats”, *Times of India*, May 6, 2010.

100 See, RBI, Macroeconomic and Monetary Developments: Third Quarter Review, 2010-11 Chapter III on “The External Economy”, at http://rbidocs.rbi.org.in/rdocs/Publications/PDFs/ 04MD240111F.pdf

that except for IT and ITES, these services would not be directly contributing to foreign earning earnings. We have seen in the foregoing that inflows into the Construction and Real Estate sector are dominated by PE/VC/HF investors and Round-tripping investments which cannot be equated with FDI. Not long ago it was reported that "RBI, which has been consistently cautious over the FDI flow into the realty sector, has warned that such massive flows could lead to speculation and over-heating of the real estate sector".[101] RBI also seems to have wanted to "take property market out of the sectors which allows FDI through the automatic route. It wants inflows routes such as participatory notes and private equity contained".[102] Indeed, FDI into the sector is subject to three-year lock-in. The present change in attitude seems to have been driven by the need to meet current account deficits and the belief that FDI inflows are longer-term commitments. The primary role of FDI has thus been reduced to a foreign exchange management tool and probably reflects a change in the global approach towards FDI. The shift in the perception of FDI where the attributes other than capital are pushed to the background can be seen from an IMF publication which when describing that FDI is favoured over other capital flows by emerging markets, explained that:

> FDI is not debt creating, is less volatile than portfolio flows, and relatively resistant during financial crises (…). FDI has *also been associated* with positive spillovers through technology transfer and training to local industry (…), and *may lead to enhanced export performance and growth* (…). (emphasis added) [103]

Thus, even the IMF is not sure of the developmental impact of FDI. FDI's contribution to enhancing host country's export potential and thus contributing to its ability to *earn* foreign exchange is also not guaranteed. No wonder, India is seeing FDI as a means of bridging the current account gap with 'stable' inflows without reference to its quality.

Apart from the policies related to environment, RBI's suggestion to address other problem areas like procedural delays, land acquisition issues and availability of quality infrastructure is more generic in nature and by itself may not ensure directing capital flows to India. There is every possibility that the fall in inflows would be used to push further opening up of the sectors which have hitherto been partially open to FDI. The need to maintain a steady stream of foreign capital is shrinking the policy space even when certain policies are not working to India's advantage.

4.2 A Case for Selective Approach towards FDI

Before seeking to benefit from FDI it is essential to clearly identify the same. Thus going back to the definitional aspect of FDI, one finds that the essential criterion followed for

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101 See: "RBI raises alarm over FDI build-up in realty", http://economictimes.indiatimes.com/ markets/real-estate/realty-trends/rbi-raises-alarm-over-fdi-build-up-in-realty/articleshow/1129254.cms

102 See: "RBI Asks Govt to ban automatic FDI in Real Estate", http://www.indianrealtynews.com/fdi-india/rbi-asks-govt-to-ban-automatic-fdi-in-real-estate.html

103 IMF, *India: Selected Issues, supra note 9.*

identifying an FDI enterprise is control/influence. While unambiguous control is generally seen in owning majority share in equity, significant influence is expected to exist when there is an equity share between 10% and 50%. It is also believed that one can have control with less than 10% share and not have control even with shares higher than 10%. The primary criteria itself is a matter of debate and FDI is open to subjective interpretation and judgment. Other items like reinvested earnings, other capital, etc. only follow from this first level identification. The whole edifice is thus built on what is well acknowledged as an 'arbitrary' cut-off point of 10%, vaguely defined 'lasting interest' and 'significant influence.[104] Indeed, it is difficult to understand the full meaning of IMF BPM6 when it says:

> Because there is control or a significant degree of influence, direct investment tends to have different motivations and to behave in different ways from other forms of investment. As well as equity (which is associated with voting power), the direct investor may also *supply other types of finance, as well as knowhow. Direct investment tends to involve a lasting relationship, although it may be a short-term relationship in some cases.* Another feature of direct investment is that *decisions by enterprises may be made for the group as a whole.* (emphasis added)[105]

On one hand, it implies that direct investment is much more than a share in equity and involves supply of other types of finance and knowhow *and* decisions are made for the group as a whole. This is more akin to investments by TNCs. However, the difficult part in this is about the 'lasting relationship' of a 'short-term' nature. Obviously, the lower limit of 10% which is neutral to the nature of the foreign investor would bring far more cross-border investments, including cases that are typically portfolio investments, into the ambit of FDI than a higher cut-off point would do. And indeed, this has been the case as India's experience described in the foregoing had demonstrated. Foreign control by itself may be important when it comes to ascertaining liabilities of various sorts or in strategic sectors. This is irrespective of whether a particular company is categorised as an FDI one or not. The two should be treated separately.

This is as far as the need to clearly identify FDI within the global and individual host country's capital flows before one can plan to use it to ones advantage. On the other hand, there is considerable body of literature which does not offer unqualified endorsement of positive impact of FDI on host countries and which implies a calibrated approach towards it. The situation is well summed up in the following:

> We know that there is a lot we still do not know about FDI and MNCs, but not exactly what or how much. ... Few undisputed insights exist on which policy makers can definitely rely. ''The economic effects of FDI do not allow for easy

[104] Supra note 33. See also: Jimmy J. Zhan, "FDI Statistics: A Critical Review and Policy Implications", paper prepared for the World Association of Investment Promotion Agencies (WAIPA), Geneva, October 2006.

[105] IMF, *Balance of Payment and International Investment Position Manual*, Sixth Edition, 2009, p. 101.

> generalizations. Empirical studies on the growth impact of FDI have come up with conflicting results.''[106]

And,

> After resolving many statistical problems plaguing past macroeconomic studies and confirming our results using two new databases on international capital flows, we find that FDI inflows do not exert an independent influence on economic growth. Thus, while sound economic policies may spur both growth and FDI, the results are inconsistent with the view that FDI exerts a positive impact on growth that is independent of other growth determinants.[107]

Following such evidence it is logical for adopting a selective approach towards FDI. For instance, it is said:

> The experience of many recent development successes supports our call for a more interventionist approach towards TNCs – which policymakers and academics from various parts of the world are embracing. Countries such as Korea, Taiwan, Singapore and China were able to incorporate TNCs within their national projects in their own terms and under their own conditions. Even Singapore, which actively promoted FDI inflows, protected strategic sectors from foreign competition and implemented different measures to promote domestic upgrading. While international agreements may prohibit some of the measures that Korea, Taiwan and Singapore implemented, there is still some policy space available for a more restrictive approach to TNCs. *To summarise, countries which manage their FDI are likely to benefit more than those which are managed by their FDI*. (emphasis added)[108]

Similarly,

> ... there are good reasons to believe that an industrialized strategy based on laissez faire attitude towards TNCs may not be as successful in the long run as a more selective, strategic approach, as seen in the examples of countries like Korea and Taiwan.[109]

At one time the expectations from FDI were rather clear; and even now the most widely accepted view is that it is much more than capital transfer. And probably that was the reason why developing countries could be convinced of the need to attract FDI. (See Box)

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106 Stephen D. Cohen, *Multinational Corporations and Foreign Direct Investment: Avoiding Simplicity, Embracing Complexity*, Oxford University Press, 2007, p. 356.

107 Maria Carkovic and Ross Levine, "Does foreign direct investment accelerate economic growth?", in Theodore H. Moran, Edward M. Graham and Magnus Blomström, *Does Foreign Direct Inevstemnt Promote Development?"*, Institute for International Economics, 2005, p. 219.

108 Eric Rugraff, Diego Sánchez-Ancochea, Andy Sumner (eds.), *Transnational Corporations and Development Policy: Critical Perspectives, Palgrave Macmillan, 2009,* pp. 305-306.

109 Ha-joon Chang, "Globalization, transnational corporations, and economic development: can the developing countries pursue strategic industrial policy in a globalizing world economy?", in Dean Baker, Gerald Epstein and Robert Pollin (eds.), *Globalization and Progressive Economic Policy*, Cambridge University Press, 1998, pp. 97-116.

Box

FDI comprises a package of resources …

Extracts from UNCTAD, *World Investment Report: Foreign Direct Investment and the Challenge of Development, 1999*.

Most developing countries today consider FDI an important channel for obtaining access to resources for development. However, the economic effects of FDI are almost impossible to measure with precision. Each TNC represents a complex package of firm-level attributes that are dispersed in varying quantities and quality from one host country to another. These attributes are difficult to separate and quantify. Where their presence has widespread effects, measurement is even more difficult. ... the assessment of the development effects of FDI has to resort either to an econometric analysis of the relationships between inward FDI and various measures of economic performance, the results of which are often inconclusive, or to a qualitative analysis of particular aspects of the contribution of TNCs to development, without any attempt at measuring costs and benefits quantitatively.

FDI comprises a bundle of assets, some proprietary to the investor. The proprietary assets, the "ownership advantages" of TNCs, can be obtained only from the firms that create them. They can be copied or reproduced by others, but the cost of doing that can be very high, particularly in developing countries and where advanced technologies are involved. Non-proprietary assets—finance, many capital goods, intermediate inputs and the like—can usually be obtained from the market also.

The most prized proprietary asset is probably technology. Others are brand names, specialized skills, and the ability to organize and integrate production across countries, to establish marketing networks, or to have privileged access to the market for non-proprietary assets (e.g. funds, equipment). Taken together, these advantages mean that TNCs can contribute significantly to economic development in host countries—if the host country can induce them to transfer their advantages in appropriate forms and has the capacity to make good use of them. (p. 25)

The development impact of FDI, however, also depends on the *dynamics* of the transfer of technology and skills by TNCs: how much upgrading of local capabilities takes place over time, how far local linkages deepen, and how closely affiliates integrate themselves in the local learning system. TNCs may simply exploit the existing advantages of a host economy and move on as those advantages erode. Static advantages may not automatically transmute into dynamic advantages. This possibility looms particularly large where a host economy's main advantage is low-cost unskilled labour, and the main TNC export activity is low-technology assembly.

The extent to which TNCs dynamically upgrade their technology and skills transfer and raise local capabilities and linkages depends on the interaction of the trade and competition policy regime, government policies on the operations of foreign affiliates, the corporate strategies and resources of TNCs, and the state of development and responsiveness of local factor markets, firms and institutions. (p. 30)

Even today in spite of a variety of foreign investors coming into play and with increasing dominance of financial investors about whose impact on host countries one is not sure of, international bodies continue to present the prospect that:

> Unlike portfolio equity and bond investments, FDI decisions are made with long-term horizons in view. They express the intention to build productive manufacturing facilities, exploit natural resources, or diversify export bases. Thus, FDI flows are less likely to be liquidated *or reversed* in times of crisis.[110] (emphasis added)

Notwithstanding the clarity in objectives and expectations from FDI the broader definition of FDI that has prevailed blurred the boundaries between portfolio and direct investments. A situation has been reached when FDI is referred to for its developmental impact even while the widely available measurement is that of BOP based FDI resulting in a wide gap between what is meant and what is measured as FDI.[111] Instead of representing capital flow with clear developmental connotation, it has turned into generic capital flow. Recent developments are consistent with these observations. For instance, substantial decrease in M&As (a good part of which is financed by private equity) and a sharp fall in 'FDI by private equity funds' rather than a slowdown in greenfield operations explain most of the drop in FDI in 2008 and 2009.[112] It is apparent that the characteristics of portfolio investments got reflected in the behaviour of globally measured FDI. Indeed a critic of UNCTAD had said:

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110 World Bank, *Global Development Finance, Charting a Global Recovery, I: Review, Analysis, and Outlook*, 2009, p. 3.

111 In the context of rising current account deficit and falling FDI inflows, the *Economic Times* said in its editorial:

> ADRs do make some investible resources available to domestic industry, but is *devoid of the specific benefits associated with FDI*, namely, strategic vision for business growth in the country, technological know-how and managerial expertise. If the government is seriously concerned about our rising current account deficit, estimated at about 3.5% of GDP, an issue that the Reserve Bank of India has also flagged, it needs to look for ways to *increase genuine, rather than sham, FDI flows*. FDI, unlike foreign institutional investment (FII) flows that are easy-come-easy-go, is not only sticky but also has *huge positive externalities in the form of ancillary industries and employment opportunities*. Today, it is hard to think of, say, Suzuki exiting India, certainly not with the ease of some foreign institutional investor. All the more reason why the government should try to reverse the recent trend in overseas capital flows characterised by a decline (in) direct investment and a rise in portfolio flows. (emphasis added)

"ADRs no substitute for FDI", *Economic Times*, January 31, 2011.

On its part a *Business Standard* editorial said on January 3, 2011 that:

> It is the composition of capital flows into India in recent times that is a cause of greater concern. India's current account deficit is being financed by short-term capital flows which, as the Financial Stability document of RBI has pointed out, is a cause for serious concern. Short-term capital flows, which increase both short-term debt and vulnerability, are notoriously foot loose and could exit at the first sign of trouble or better opportunity elsewhere, leaving India dangerously vulnerable. A healthy capital inflow mix would include a greater share of *FDI, which is not only more stable, but brings with it a basket of benefits such as technology transfer, access to export markets, best management practices among others* which can have economy-wide benefits, with the right policy mix in place. (emphasis added)

http://www.business-standard.com/india/news/the-external-constraint/420434/

112 UNCTAD, *World Investment Report*, 2010.

> For, despite the eclectic nature of its presentation (where it sometimes criticizes speculative capital), UNCTAD/WIRs leave the overall impression that all the figures that it provides for FDI are indeed "genuine" FDI which plays a "significant" role in the development of Third World countries. This is, to say the least, highly misleading and improper.[113]

While India's FDI data did reveal some major deviations and specific features one does not know the extent of such anomalies in respect of FDI data of other countries. It is also necessary to underline here that a number of companies which are reported as recipients of FDI do not appear among the foreign affiliates in India reported on the ITC-UNCTAD database www.investmentmap.org. The information for the database is provided by Dun & Bradstreet—world's leading corporate information provider.[114] One is not sure about other countries.

The aggregate FDI data reported by UNCTAD needs to be understood with many a qualification. For instance, while UNCTAD in its "Global and Regional FDI Trends in 2010" reported that global capital flows *stagnated during 2010* compared to 2009, the details show that "(I)mproved economic performance in many parts of the world and increased profits of foreign affiliates, especially in developing countries, lifted reinvested earnings to nearly double their 2009 level".[115] A look at the accompanying graph clearly suggests that actual cross-border flows would have *fallen considerably during 2010* thus giving scope to a completely different interpretation of the global situation.

The difference between FPI and FDI having been minimised through the propagation of a liberal BOP-based definition, an environment of competition among countries for

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113 Yash Tandon, "FDI, globalization, UNCTAD and human development", available at http://www.twnside.org.sg/title/fdi.htm. Mr. Tandon was former Executive Director, South Centre, Geneva.

114 In fact, it is difficult to reconcile how the number of foreign affiliates are arrived at. For instance, according to the database, there are 59 affiliates under the category 'Publishing, printing and reproduction of recorded media'. But a closer examination reveals that there are no more than 33 affiliates and the higher number is explained by the fact that offices of the same affiliate in different cities are counted as affiliates. That is how Scholastic Corp of USA is shown to have 13 affiliates in India while in actuality only one affiliate Scholastic India Pvt Ltd is shown with 13 entries: two each in Bangalore, Chennai, Gurgaon, Kolkata, Mumbai, Pune and one in Delhi. Employment data is reported only against its Gurgaon office. The registered office of the company is in Gurgaon. The rest may be branches or offices of 'city-based educational coordinators'. Similarly, Cadbury UK's some of the eight affiliates in India are either regional offices/factories/sales offices of Cadbury India Ltd in different locations. Incidentally, some of the factories (Himachal Pradesh, Pune and Gwalior) do not appear among the eleven. Surprisingly, Cadbury India's starting year is reported as 1990 whereas the company started its operations in India in 1948, which fact is also confirmed by the MCA website. On the other hand, Unilever Plc is reported to have 11 affiliates. One, however, finds only four unique companies in the details section with Hindustan lever Ltd appearing six times and Lever India Exports Ltd three times. The remaining are Diversey Lever and Vashisti Detergents Ltd. Surprisingly except for Lever India Exports Ltd none of the Hindustan Unilever's other nine subsidiaries, or its joint ventures Hi-Tech Surfactants Ltd or Kimberly Clark Lever Pvt Ltd. find a place among the affiliates.

Further, if we go by UNCTAD the number of foreign affiliates in China declined from 42,753 in 2004 to 25,267 whereas for India they increased from 518 to 3,891.

115 Supra note 59.

attracting FDI has emerged fuelled by indicators like FDI Confidence Index, Inward FDI Attractiveness index, Inward FDI Performance Index, etc. Developing countries vie among themselves for larger volumes of FDI. It was indeed argued against such comparisons:

> India has the potential for attracting increased volumes of FDI. She can do so with a set of policies which are in the interests of not only foreign investors but also domestic investors. *It is though a bit farfetched to argue that FDI is a panacea for the development problem and India should throw all doors wide open to FDI. It would also be a folly to woo FDI if only because China attracts relatively high volumes of FDI.* [116] (emphasis added)

FDI policies need not have to be unidirectional. Just as they are liberalized, they could also be tightened if the situation so warrants.

> …it would be foolish to have either uniformly restrictive or uniformly liberal policies towards TNCs across different industries. This also means that the same industry may, and indeed should, become more or less open to FDI over time, depending on the changes in various internal and external conditions that affect it.[117]

After almost twenty years of trying to attract FDI probably the time has come to review India's FDI policy, not from the view point of maximizing the inflows but from the perspective of bridging the gaps and gaining from it.

4.3 Need for a Relevant Data System

While it may be necessary to follow the international criteria for balance of payment purposes, a detailed break-up of the foreign capital inflows is unavoidable for a proper assessment of their developmental impact, the *raison d'etre* for FDI. Also required is a reliable data system which enables analysis of operations of a representative set of Indian companies, including FDI companies. Unfortunately, by switching over to the new definition of 'FDI companies' and abandoning what was probably the more appropriate category of FCRCs by the RBI, the representative character of the studies on foreign companies in India has become even more debatable. The control aspect underlying the definition of FCRCs more closely reflected provisions of the Companies Act. In fact, thanks to the poor information base of the Indian corporate sector itself, today the role

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[116] See: V.N. Balasubramanyam and Vidya Mahambare, "Foreign Direct Investment in India", paper presented at a workshop on Foreign Direct Investment in Developing Countries held at the Lake District, September 13–14, 2002. This was in response to Nirupam Bajpai and Jeffrey D. Sachs, "Foreign Direct Investment in India: Issues and Problems", Development Discussion Paper No. 759, Harvard Institute for International Development, March 2000 wherein it was posed:

> Why is it that India, which provides the largest market after China in the developing world is unable to attract substantial volume of FDI? Further, when it comes to comparing China and India, why can India not match or even outpace China in attracting FDI given India's superior conditions regarding the rule of law, democracy, and the widely spoken English language?

[117] Supra note 109.

and place of FDI in the economy is not known with any reasonable degree of accuracy. Consequently, studies are often based upon small sets of foreign companies identified from databases which have lost much of their relevance in this respect notwithstanding the fact that they do try to cover some unlisted companies as well.[118] With the importance of financial investors and Round-tripping investments in India's FDI inflows, there is a need to classify the investments according to the nature of foreign investors. Even OECD suggested that when the Round-tripping phenomenon becomes significant these should be indicated as separate supplementary breakdowns.[119]

Both at the global level and at the national level in India considerable time and other resources are being invested to promote FDI. To assess its contribution the need for a proper information base on the activities of FDI companies is well accepted. It is worth referring to UNCTAD when it said:

> FDI data alone are not enough to assess the importance and impact of FDI in host economies. They should be complemented with statistical information on the activities of TNCs and their foreign affiliates (e.g. sales, employment, trade, research and development (R&D)).[120]

It is also relevant to refer to Lipsey when he said:

> One would need an unusual type of FDI data to explain the role of such an investment and such an affiliate on the host economy, but the value of the investment stock or the corresponding flows, and the value of assets, sales, and value added are uninformative on the subject. Only host country data collection on establishment and firm bases, including real inputs such as labor and physical capital, and R&D, and financial flows such as tax payments, can begin to reveal host country impacts.[121]

India and probably many other countries are nowhere near having such a data system. Important components of the reported FDI inflows like 'reinvested' earnings and 'other capital' are simple estimates the veracity of which one cannot vouch for. It is time the

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[118] While many new foreign companies are not getting listed on the Indian stock exchanges, some of the important existing ones had even got delisted and more have plans to exit. The then Finance Minister, for instance, reported that: "Between 1997-1998 and 2002-2003 we have a total of 62 companies that have been actually de-listed. Out of these 62 companies, 41 are Indian companies and 21 are categorised as multi-national companies."

Reply to Lok Sabha Starred Question No. 64 dated February 21, 2003.

Some of the prominent delisted ones are: Avery, Bosch Rexroth, Cadbury, Carrier Aircon, Digital Globalsoft., Hoganas India, iGATE Global Solutions, ITW Signode India, Kodak, Ondeo Nalco, Otis, Panasonic AVC, Philips, Ray Ban, Reckitt Benckiser, Sandvik, Syngenta, Tektronix, Vickers Systems, Wartsila and Yokogawa India.

See also: http://ahmedsk00.blogspot.com/2007/06/mncs-likely-to-delist-names-include-i.html

[119] OECD, *Benchmark Definition of Foreign Direct Investment: Fourth Edition*, 2008, p. 159.

[120] UNCTAD, *World Investment Report*, 2006, p. 13.

[121] Robert E. Lipsey, "What do users of FDI data want to learn from them and do the data tell them the truth?", paper presented at the UNCTAD Expert Meeting on Capacity Building in the Area of FDI: Data Compilation and Policy Formulation in Developing Countries, 12-14 December 2005.

Indian policymakers start making a clear distinction between different types of foreign investors which could help them in their own assessment of the situation on the one hand and enable assessment of benefits/costs by others, on the other.[122] In the absence of such an analysis, success of the FDI policy would only be measured in terms of attracting larger and larger amount of inflows to achieve which, beyond a point, one has no option but to open up more and more. And there is a limit to it. There are multiple official agencies like RBI, Ministry of Commerce & Industry, Ministry of Finance, Foreign Investment Implementation Authority (FIIA), FIPB, SEBI, Central Statistical Organisation (CSO), National Manufacturing Competitiveness Council, Investment Commission, Competition Commission, Public-Private Partnerships with industry bodies and finally the Ministry of Corporate Affairs itself in dealing with foreign entities. What is required is an open mind and commonality in approach to unravel the FDI phenomenon and to maximise the benefits from it.

[122] The inflows data received by RBI regional offices being offered as proxy for state-wise distribution of FDI reflects poorly on the existing information base on FDI in India. As noted above, one cannot take even UNCTAD's reporting of foreign affiliates in the country at its face value.

Annexure-A

Illustrative Cases of FDI Inflows which involve Acquisition of Companies in India

Route, Month & Year	*Indian Company*	*Foreign Investor*	*Country*	*Inflow (₹Cr.)*
R-1208	Ambuja Cement India Ltd	Holderind Investments Ltd	Mauritius	810.03
A-0407	*Anchor Electricals Pvt Ltd*	*Matsushita Electric Works Ltd*	*Acquisition of Share*	*1,440.83*
R-0807	Anchor Electricals Pvt Ltd	Matsushita Electrical	Japan	425.67
A-0108	*Anchor Electricals Pvt Ltd*	*Matsushita Electric Works Ltd*	*Japan*	*104.99*
R-4906	Astrix Laboratories Ltd	Aspen Pharmacare Holding Ltd	South Africa	164.28
R-0508	Balaji Telefilms Ltd	Asian Broadcasting FZ-LLC	U.A.E.	123.25
R-0608	Bhukhanvala Diamond Systems Pvt Ltd	Hilti Far East Pvt Ltd	Singapore	23.74
A-0507	*Bombay Stock Exchange*	*Atticus Mauritius*	*Mauritius*	*160.62*
A-0507	*Bombay Stock Exchange*	*Callwell Asset Management*	*Acquisition of Share*	*160.62*
A-0507	*Bombay Stock Exchange*	*Katriel Investment Ltd*	*Acquisition of Share*	*160.62*
F-0607	Bombay Stock Exchange	Deutsche Boerse AG	Germany	200.78
F-0607	Bombay Stock Exchange	Singapore Stock Exchange	Singapore	200.78
R-0608	Centum Frequency Products Pvt Ltd	Rakon (Mauritius) Ltd.	Mauritius	26.29
R-0705	Dabur Pharma Ltd	International Finance Corp	U.S.A.	65.58
F-0505	DCM Benetton India Ltd	-	Luxembourg	22.50
F-0505	Emergent Genetics India Pvt Ltd	-	Cayman Island	64.80
R-1208	Fresh & Honest Cafe Ltd	Lavazza Netherlands BV	Netherlands	30.00
R-0608	Karnavati Rasayan Ltd	Cabb Holding Gmbh	Germany	22.20
R-0908	MTR Foods Ltd	Orkla Asia Pacific Pte Ltd	Singapore	50.00
R-0908	MTR Foods Ltd	Orkla Asia Pacific Pte Ltd	Singapore	50.00
R-1006	Mysore Cements Ltd (Now Heidelberg Cement India)	Cementrum 1 BV	Netherlands	359.10
A-1006	*Mysore Cements Ltd (Now Heidelberg Cement India)*	*Cementrum 1 BV*	*Netherlands*	*203.00*
A-0307	*Mysore Cements Ltd (Now Heidelberg Cement India)*	*Cementrum 1 BV*	*Netherlands*	*77.72*
A-0708	*My Home Industries Ltd*	*CRH India*	-	*1,170.53*
R-0708	My Home Industries Ltd	CRH India Investments BV	Netherlands	517.36
F-0107	Parryware Roca Pvt Ltd	Roca Sanitario S A	Spain	173.98
A-0808	*Parryware Roca Pvt Ltd*	*Roca Bathroom Investments*	*Acquisition of Share*	*747.39*
R-1208	Shyamtelelink Ltd	Sistema Joint Stock Financial Corp	Russia	1,482.00
R-0608	SJK Steel Plant Ltd	Corporaction Sidenor Say Cia Src	Spain	79.12
F-1008	SKF Technologies Pvt Ltd	Aktiebolaget SKF	Sweden	35.04
A-0208	*Sky Gourmet Catering Pvt Ltd*	*IHC Mauritius Corp*	*Mauritius*	*72.21*
R-1108	Sky Gourmet Catering Pvt Ltd	IHC Mauritius Corp	Mauritius	74.51
R-0607	Solvay Specialities India Pvt Ltd	Solyay Holding Netherland BV	Netherlands	225.00
R-1007	UTV Software Communication Ltd	Walt Disney Co	Singapore	65.45
R-0105	Vijay Industries & Projects Ltd	-	U.K.	47.79

Note: R: RBI Automatic Route; F: FIPB Approval; A: Acquisition Route. The latter have been included to show the contradictory classification of the inflows from the same foreign investor in the same Indian company.

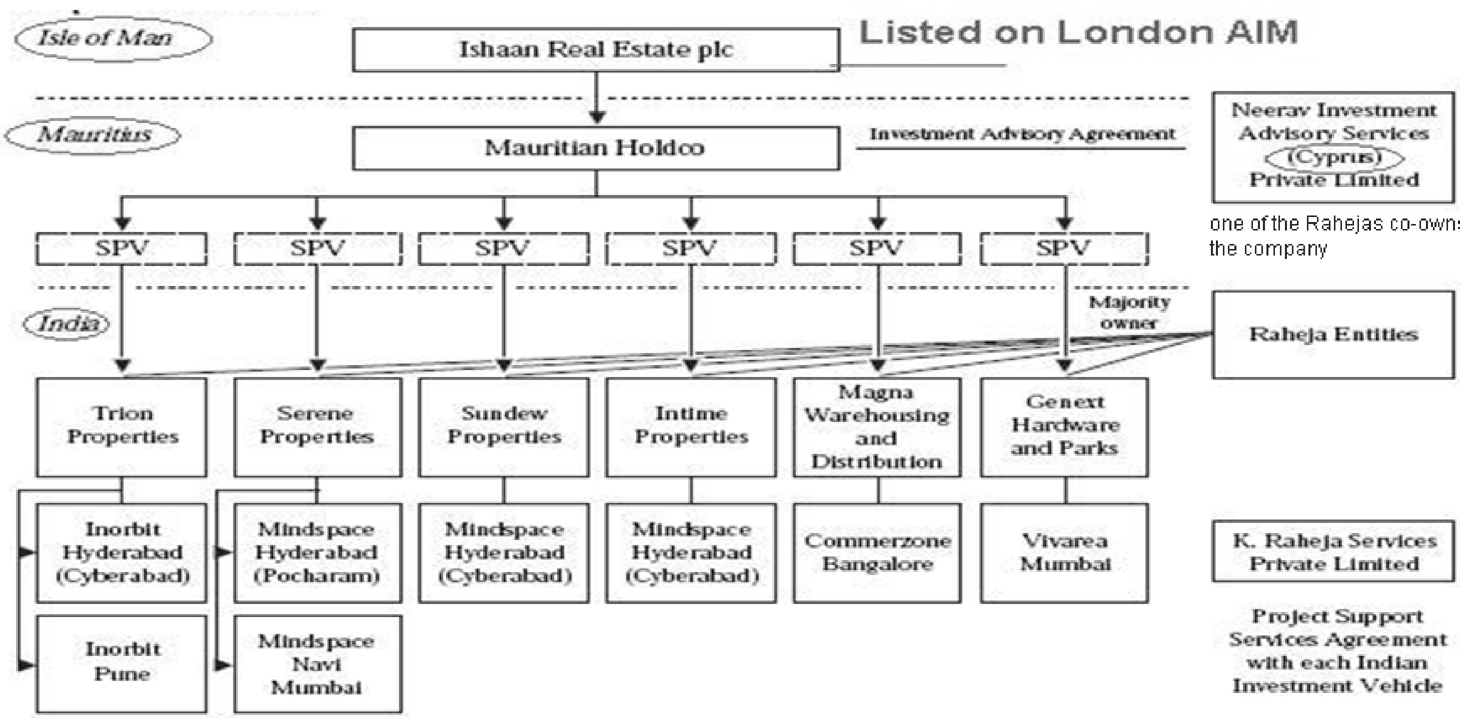
Annexure-B

Illustrative Cases of Large FDI Inflows where the Indian Investee Company/Promoters Appears to have Direct Relationship with the Foreign Investor (in ₹ Million)

Indian Investee Company	*Entry Route*	*Source Country*	*Foreign Investor*	*Inflow*
Adani Energy Ltd	Acquisition	Acquisition of Shares	Opal Travels Ltd	571
Asrani Inns and Resorts Pvt Ltd	Automatic	British Virginia	Global Technology & Trademarks Ltd.	838
Ballarpur Industries Ltd	Acquisition	Unindicated Country	Ballarpur Industries Ltd.	2,785
BILT Graphic Paper Products Ltd	Acquisition	Acquisition of Shares	Ballarpur Paper Holding Bv	6,379
BILT Paper Holdings Ltd	Automatic	Mauritius	NQC Global (Mauritius) Ltd	765
Cox & Kings (India) Pvt Ltd	Acquisition	Mauritius	Kuber Investments (Mauritius) Pvt Ltd	431
Deeksha Holdings Ltd	FIPB	U.K.	Richmond Enterprises Sa	792
Dimexon (India) Holding Pvt Ltd	FIPB	Netherlands	Dimexon Int'l Holding B.V.	499
Essar Bulk Terminal Ltd	Automatic	Cyprus	Essar Shipping & Logistics Ltd.	820
Essar Bulk Terminal Ltd	Automatic	Cyprus	Essar Shipping & Logistics Ltd.	445
Essar Construction Ltd	Acquisition	Mauritius	Essar Projects	1,333
Essar Construction Ltd	Automatic	U.A.E.	Essar Projects Ltd	905
Essar Power	Acquisition	Mauritius	Essar Infrastructure	716
Essar Projects	Acquisition	Unindicated Country	Essar Investment Ltd	4,092
Essar Steel (Hazira) Ltd	Automatic	Mauritius	Essar Steel Holdings Ltd	2,230
Essar Steel Ltd	Acquisition	U.S.A.	Essar Logistics Holdings Ltd	19,039
ETHL Global Capital Ltd	FIPB	Mauritius	Hazira Steel 2	2,250
Geetanjali Effective Realty Sol. Pvt Ltd	Automatic	Mauritius	SEZ Developers Ltd	428
Genext Hardware & Parks Pvt Ltd	Automatic	Mauritius	1 Company (Mauritius) Ltd	625
GTL Infrastructure Ltd	Automatic	Mauritius	Technology Infrastructure	862
GVK Power And Infrastructure Ltd	Automatic	Mauritius	Transoceanic Projects	1,177
Hazira Plate Ltd	Automatic	Mauritius	Essar Steel Holdings Ltd	1,154
Hazira Plate Ltd	Automatic	Mauritius	Essar Steel Holdings Ltd	996
Hazira Plate Ltd	Automatic	Mauritius	Essar Steel Holdings Ltd	495
Hutchison Essar Ltd	FIPB	Mauritius	Essar Com Ltd	1,091
Ispat Industries Ltd	Acquisition	Unindicated Country	Ispat Industries Ltd.	624
Jindal Stainless Ltd	Automatic	Cayman Island	Jindal Overseas Holdings Ltd.	700
Jm Financial Ltd	FIPB	Mauritius	JM Financial Property Fund	593
Jubilant Off Shore Drilling Pvt Ltd	Automatic	Cyprus	Jubilant Energy India Ltd	715
Jubilant Off Shore Drilling Pvt Ltd	Automatic	Cyprus	Jubilant Energy India Ltd	429
Jubilant Oil & Gas Pvt Ltd	Automatic	Cyprus	Jubilant Oil And Gas (I) Ltd	715
Jubilant Oil & Gas Pvt Ltd	Automatic	Cyprus	Jubilant Oil And Gas (I) Ltd	592
Kingfisher Airlines Ltd	Automatic	British Virginia	UB Overseas Ltd.	502
Magna Warehousing & Distribution Pvt Ltd	Automatic	Mauritius	I-4 Company (Mauritius) Ltd	465

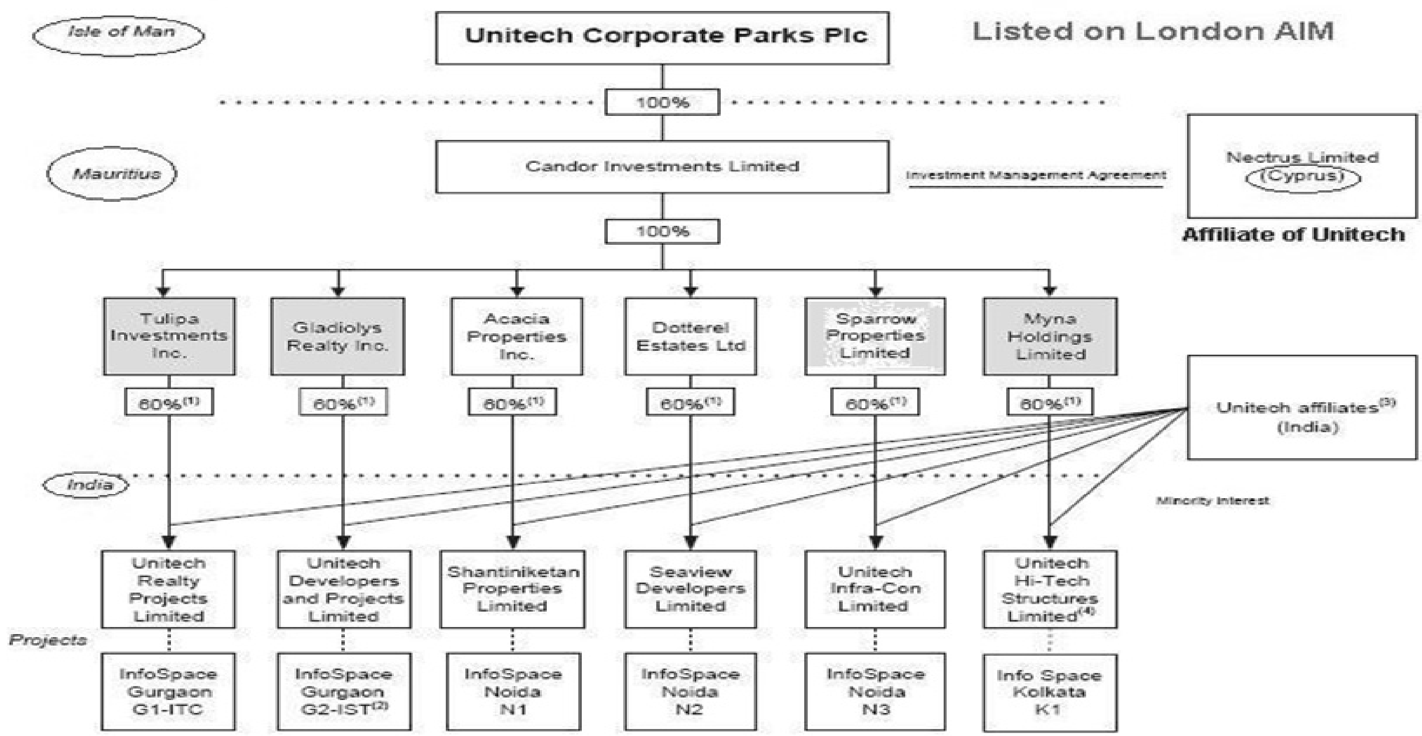
Indian Investee Company	*Entry Route*	*Source Country*	*Foreign Investor*	*Inflow*
Newfound Properties & Leasing Ltd	Acquisition	Acquisition of Shares	Newfound Properties & Leasing Ltd	1,640
Orient Green Power Co Ltd	Automatic	Singapore	Orient Green Power Pte Ltd	757
Ozone Projects Pvt Ltd	Acquisition	Mauritius	Urban Infrastructure Real Estate Fund	844
PVP Ventures Pvt Ltd	Automatic	Mauritius	Platex Ltd	3,777
PVP Ventures Pvt Ltd	Automatic	Mauritius	Platex Ltd	3,758
PVP Ventures Pvt Ltd	Automatic	Mauritius	Platex Ltd	1,329
Rakindo Kovai Township	FIPB	Mauritius	Rakeen P. Ltd	1,274
Reliance Gas Transportation Infrastructu	Automatic	Singapore	Biometrix Marketing Pvt. Ltd.	8,756
Reliance Gas Transportation Infrastructu	Automatic	Singapore	Biometrix Marketing Pvt. Ltd.	7,864
Reliance Gas Transportation Infrastructu	Automatic	Singapore	Biometrix Marketing Pvt. Ltd.	7,665
Reliance Gas Transportation Infrastructu	Automatic	Singapore	Biometrix Marketing Pvt. Ltd.	7,000
Reliance Ports & Terminals Ltd	Automatic	Singapore	Biometrix Marketing Pvt. Ltd.	8,303
Reliance Utilities Ltd	Automatic	Singapore	Biometrix Marketing Pvt. Ltd.	7,000
Relogistics Infrastructure Pvt Ltd	Automatic	Singapore	Biometrix Marketing Pvt. Ltd.	18,519
Ritambara Agents Pvt Ltd	Automatic	Mauritius	Ispat Teleco. Holdings Ltd.	3,741
Seaview Developers Ltd	Automatic	Mauritius	Dotterl Estate Ltd	1,875
Serene Properties Pvt Ltd	Automatic	Mauritius	I-3 Company (Mauritius) Ltd	832
Shantineketan Properties Ltd	Automatic	Mauritius	Acacia Properties	1,111
Shashwat International Ltd	Automatic	Mauritius	Orind South Asia Ltd	536
Shashwat International Ltd	Automatic	Mauritius	Orind South Asia Ltd	536
Solaris Biochemicals Ltd	Automatic	Mauritius	NQC International Mauritius	590
Solaris Chem Tech Ltd	Automatic	Mauritius	NQC International Mauritius	1,492
Steel Corporation Of Gujarat Ltd	Automatic	Mauritius	Gujarat Steel Holdings Ltd.	1,168
Teesta Urja Ltd	Automatic	Singapore	Athena Projects Pte Ltd	1,642
Unitech Developers & Projects Ltd	Automatic	Mauritius	Gladioys Realty Inc	3,266
Unitech Hitech Structures Ltd	Automatic	Mauritius	Myna Holdings Ltd	3,228
Unitech Infra Com Ltd	Automatic	Mauritius	Sparrow Properties Ltd	1,932
Unitech Reality Projects Ltd	Acquisition	Mauritius	Tulipa Investments Inc, Mauritius	5,092
United Breweries (Holding) Ltd	Acquisition	British Virginia	Firstart Inc	862
Vadinar Oil Terminal Ltd	Automatic	Cyprus	Essar Shipping & Logistics Ltd.	897
Vedanta Alumina Ltd	Automatic	Mauritius	Twinstar Holdings Ltd	4,421
Vedanta Alumina Ltd	Automatic	Mauritius	Twinstar Holdings Ltd	3,143

Annexure-C1
Corporate structure of Ishaan Real Estate plc.



Source: Ishaan Real Estate plc., AIM Admission Document. AIM is Alternative Investment Market of the London Stock Exchange and is significantly less regulated.

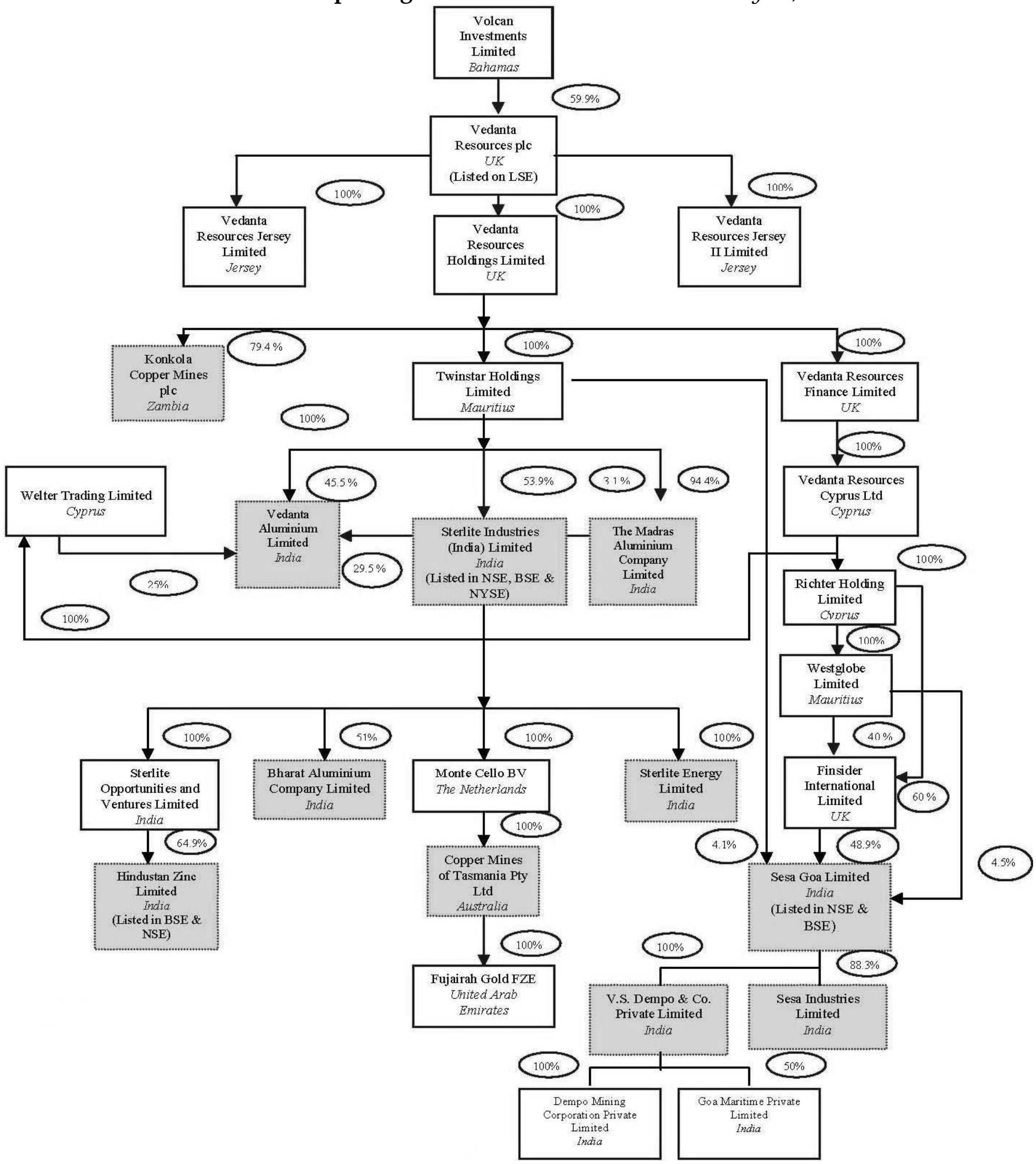
Annexure-C2
Corporate Structure of Unitech Corporate Parks plc.



Source: UNITECH Corporate Parks plc. AIM Admission Document. AIM is Alternative Investment Market of the London Stock Exchange and is significantly less regulated

Annexure-C3

Vedanta Group's Organisational Chart# *as on February 28, 2010*



Note: (1) It was explained that "We also own certain other non-operating subsidiaries that are not material and are not shown in the organisational chart …".

(2) Volcan Investments Ltd owns 162,250,000 Ordinary Shares, or approximately 59.88% of the issued ordinary share capital of Vedanta. Volcan is owned and controlled by the Anil Agarwal Discretionary Trust (Trust). Onclave PTC Ltd (Onclave) is the trustee of the Trust and controls all voting and investment decisions of the Trust. As a result, shares beneficially owned by Volcan may be deemed to be beneficially owned by the Trust and, in turn, by Onclave. Mr. Anil Agarwal, the Executive Chairman of Vedanta (…), may be deemed to have beneficial ownership of shares that may be owned or deemed to be beneficially owned by Onclave.

(3) Shading indicates operating companies.

Source: Offering Circular dated March 26, 2010 available at http://www.vedantaresources.com/uploads/offeringcircular42017bond.pdf

Annexure D
Educational Qualifications and Past Experience of Indians* Working with General Atlantic, a Leading US-Based PE Firm

Name	*Position*	*Educational Qualifications*	*Previous Employment*
Havaldar, Abhay	Managing Director	1. Univ. of Bombay, Bachelor Degree (Electrical Engineering); 2. **London Business School**, Masters in Management	Partner at **Draper International** & **ConnectCapital**
Pandit, Ranjit	Managing Director	1. University of Bombay, BE (Elect. Engg); 2. **Wharton School**, MBA	Managing Director, **McKinsey & Co**
Rai, Raul R.	Managing Director	1. Boston University, B.A. in Computer Science and Economics; 2. **Harvard Business School**, MBA	1. **Vizzavi Ltd., London**, Corporate Strategy & Planning Director. 2. Vice President in the Communication, Media & Technology group at **Goldman Sachs**; 3. **UBS**: Managing Director and Global Co-Head of Software Investment Banking
Sharma, Sunish	Managing Director	1. IIT Delhi, MTech; 2. **Harvard Business School**; MBA	1. Program Associate, Bill & Melinda Gates Foundation 2. Business Analyst, **McKinsey & Co**
Agrawal, Abhishek #	Vice President	**Harvard Business School**, MBA; **Wharton School**, BS in Economics	1. **Lazard's** investment banking group and 2. **Lazard Technology Partners**, a venture capital firm.
Mittal, Nishant	Vice President	1. Delhi College of Engineering; B.E.; 2. University of California Irvine; M.S. in Biomedical Engg; 3. **Stanford Graduate School of Business**; MBA	Business Analyst, **McKinsey & Co**
Sharma, Nishant	Vice President	1. IIT Delhi, M.Tech; 2. **Harvard Business School**, MBA	1. Business Analyst, **McKinsey & Co;** 2. Bill & Melinda Gates Foundation
Soni, Amit #	Vice President	1. B.Tech, IIT Delhi; 2. **Wharton School**, MBA	1. Associate Director, **3i Plc**; 2. Bill & Melinda Gates Foundation; 3. **McKinsey & Co**
Ahmed, Tariq	Senior Associate	**Ross School of Business**, University of Michigan, BBA	1. **Morgan Stanley**, Analyst; 2. **AEA Investors**, Senior Associate; 3. **Blue River Capital**, Vice President
Mehta, Parin	Senior Associate	1. Mumbai University, BE.; 2. Sydenham Institute of Mgt Studies, MBA.	1. Research Analyst, **McKinsey & Co;** 2. Senior Consultant, **Capgemini Consulting.**
Sood, Rajat #	Senior Associate	1. IIT Delhi, B.Tech. (Elect. Engg); 2. IIM Calcutta, MBA	Associate, **McKinsey & Co**
Marathe, Nikhil	Associate	1. Karnataka University; B Com; 2. Institute of Chartered Accountants of India	1. **Merrill Lynch;** 2. **Morgan Stanley** Advantage Services, Associate
Jain, Pratik	Analyst	1. Lucknow University, B.Com; 2. IMT Ghaziabad, MBA	1. First Global Finance; Research Analyst; 2. **JPMorgan** Services India, Analyst

* Identified on the basis of individuals' names.
# Based in New York and the remaining, in Mumbai.

The PE Firm's Senior Management

Name	*Position*	*Educational Qualifications*	*Previous Employment*
Steven A Denning	Chairman	**Stanford Business School**, MBA; Naval Postgraduate School, MS	Consultant, **McKinsey & Co.**
William E Ford	CEO	**Stanford Graduate School of Business**; MBA	**Morgan Stanley & Co**. as an investment banker.
John Bernstein	Managing Director	Downing College, **Cambridge University**; M.A.	Partner, Advent International
Mark F. Dzialga	Managing Director	**Columbia University Graduate School of Business**; MBA,	Co-head of Merger Technology Group, **Goldman Sachs Group**, Inc
William O. Grabe	Managing Director	**UCLA Graduate School of Business**; MBA, 1963 and New York University; BS, 1958	IBM Vice President, General Manager, Marketing and Services, IBM United States
Abhay Havaldar	Managing Director	**London Business School**; MA, 1994 and Degree in Electrical Engineering from University of Bombay.	Partner, ConnectCapital
David C. Hodgson	Managing Director	**Stanford Graduate School of Business**; MBA, 1982 and Dartmouth College; BA	President, New England Software
Rene M. Kern	Managing Director	**Wharton School and School of the Arts & Sciences**, MBA/MA	Vice President, **Morgan Stanley & Co**. was a management consultant with Bain & Company in Boston, MA
Jonathan Korngold	Managing Director	**Harvard Business School**; MBA and Harvard University; BA	**Goldman Sachs** and Company
Chris Lanning	Managing Director	**University of Virginia**; JD, 1995 and University of Virginia; BA, 1991	Senior Corporate Associate, Hunton & Williams, a Law Firm
Jeff Leng	Managing Director	**Wharton School of Business**, University of Pennsylvania; MBA	Managing Director, **Warburg Pincus**
Anton Levy	Managing Director	**Columbia University Graduate School of Business**; MBA	Financial Analyst, **Morgan Stanley**
Adrianna C. Ma	Managing Director	**Harvard Business School**; MBA, 2000 and Massachusetts Institute of Technology; MEng and BS	Vice President, **Morgan Stanley & Co**
Marc F. McMorris	Managing Director	**Wharton School**, University of Pennsylvania; MBA	Vice President, **Goldman Sachs Group**
Thomas Murphy	Managing Director	**Stern School of Business**, New York University; MBA	Senior Accountant, Deloitte & Touche
Fernando Marques Oliveira	Managing Director	BS; **Fundação Getulio Vargas**, São Paulo	Director, Grupo Icatu
Ranjit Pandit	Managing Director	**Wharton School**, University of Pennsylvania; MBA	Managing Director, **McKinsey & Co**
Drew Pearson	Managing	School of the Arts & Sciences,	Business Analyst, **McKinsey & Co**

Name	*Position*	*Educational Qualifications*	*Previous Employment*
	Director	University of Pennsylvania; MA/BA, 1994 and The Wharton School, University of Pennsylvania; BS	
Raul R. Rai	Managing Director	**Harvard Business School**; MBA, 1996	Managing Director, **UBS Goldman Sachs** in New York and London, as Vice President in the Communications, Media & Technology group
David Rosenstein	Managing Director	**New York University School of Law**; JD, 1993	Associate at the New York law firm of Paul, Weiss, Rifkind, Wharton & Garrison.
Sunish Sharma	Managing Director	**Indian Institute of Management**, MBA, 1997; Indian Institute of Cost and Work Accountants, Cost & Work Accountant	Engagement Manager, **McKinsey & Co**
Tom Tinsley	Managing Director	**Stanford Graduate School of Business**; MBA, 1978 and University of Notre Dame; BA, 1975	Chairman and CEO, Baan Company N.V. and Director, **McKinsey & Co**
Philip P. Trahanas	Managing Director	**Wharton School,** University of Pennsylvania; MBA, 1996, The Moore School, University of Pennsylvania	Senior Associate, **Morgan Stanley**
Florian Wendelstadt	Managing Director	**EAP - ESCP; Masters and Dipl Kfm,** 1993 and University of Passau; BA, 1990	Consultant, **Bain Consulting**

Source: Based on the details given at the company's website : http://www.generalatlantic.com
The shaded entries are common to the first list.

Annexure E

Table E.1

Industry/Financing Stage-wise Distribution of PE/VC Investment (2004-2008)

Sector	*Share in Total Investment (%)*				
	2004	*2005*	*2006*	*2007*	*2008*
IT & ITES	42.66	12.32	23.86	6.50	11.67
Computer-Hardware	2.75	1.90	0.67	1.13	1.63
Healthcare	11.10	15.77	5.83	3.40	6.02
Manufacturing	15.20	18.50	11.71	7.56	9.19
Engineering & Construction	12.21	6.77	12.05	13.37	27.52
Telecom & Media	3.91	4.49	14.84	21.34	14.96
Transportation & Logistics	0.26	3.48	5.13	4.23	4.92
Financial Services	3.89	13.53	16.45	35.07	10.97
Non-Financial Services	3.23	12.23	6.04	5.41	7.63
Others	4.78	11.02	3.41	1.98	5.50
Financing Stage					
Early	4.55	5.16	7.59	12.47	3.04
Growth	11.31	8.42	16.82	20.41	12.08
Late	20.00	27.68	31.81	24.82	62.51
Pre-IPO	-	4.76	1.99	3.63	4.63
PIPE	34.38	41.97	21.11	33.61	16.11
Buyout	29.76	12.00	20.67	5.07	1.63
Total Investment ($ mn.)	1,759.85	2,108.90	10,095.19	22,014.06	8,117.91

Source: Based on Thillai Rajan A. and Ashish Deshmukh, "India Venture Capital and Private Equity Report", Department of Management Studies, Indian Institute of Technology Madras, 2009.

Table E.2

Stage-wise Distribution of PE/VC Investments in Various Sectors (2004-08)

Sector	*Shares of Different Financing Stags in Percentages*						*Total Investment*
	Early	*Growth*	*Late*	*Pre-IPO*	*PIPE*	*Buyout*	*($ mn.)*
IT & ITES	10.53	16.90	18.39	1.25	10.26	42.66	5,797
Computer-Hardware	10.96	44.57	21.86	6.18	11.79	4.65	538
Healthcare	5.16	17.98	47.02	2.35	26.09	1.40	2,353
Manufacturing	0.69	8.72	39.48	1.24	44.82	5.05	4,249
Engineering & Construction	10.46	23.71	40.08	6.03	17.98	1.74	6,751
Telecom & Media	1.11	8.29	58.15	1.77	29.15	1.53	7,575
Transportation & Logistics	9.55	7.89	41.38	7.73	22.68	10.76	1,927
Financial services	17.11	22.51	14.47	1.69	40.93	3.29	10,626
Non-Financial services	11.98	23.82	32.80	4.21	14.89	12.31	2,735
Others	0.51	7.11	24.24	17.96	34.60	15.57	1,544
All	8.95	17.12	33.30	3.35	27.96	9.33	44,096

Source: See Table E.1.

Table E.3

Financing Stage wise Distribution of Investment in 2007 in Different Regions and India

in %

Financing Stage	*India*	*Asia*	*North America*	*Europe*
Early	12.50	8.00	6.00	3.00
Expansion (Growth + Late)	45.30	20.00	11.00	13.00
Other (PIPE+Pre-IPO)	37.20	24.00	12.00	5.00
Buyout	5.00	48.00	71.00	79.00
All	100.00	100.00	100.00	100.00

Source: See Table E.1.

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