The Expansion of Outward FDI: A Comparative Study of China and India

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The last two decades have witnessed a significant rise and expansion in outward foreign direct investment (OFDI) from China and India. This paper discusses the development process of China's and India's OFDI since the early 1980s, analysing the major driving factors and determinants behind their enterprises' "going out" strategies, and comparing the different structures of their OFDI. The main conclusion is that the OFDI from China and India is likely to expand further in the future as the two giants aspire to become significant regional and global players in their respective industries.

Introduction

The past two decades have witnessed a significant rise in outward foreign direct investment (OFDI) from developing countries. According to the 2008 *World Investment Report*, OFDI from developing countries rose from USD6 billion between 1989 and 1991 to USD225 billion in 2007, with the share in total global outflows growing from 2.7 per cent to nearly 13 per cent during this period. OFDI from developing countries continued to rise

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by 3 per cent in 2008, although it began to decline in the first half of 2009.[1] OFDI from some major economies in Asia generally slowed down in early 2009, as the global financial crisis largely reduced the ability and motivation of many transnational companies (TNCs) from these economies to invest abroad. For example, FDI outflows from all Asian newly industrialised economies (NIEs) declined by 2 per cent in Hong Kong, 7 per cent in Taiwan, 18 per cent in Korea, and a massive 63 per cent in Singapore.[2]

In contrast to this, the growing OFDI from China and India is particularly notable. Their share in total East, South and Southeast Asian outflows rose from 23 per cent in 2007 to 37 per cent in 2008. Despite the global financial crisis, FDI from China, in particular, reached USD53.8 billion in 2008, an increase of over 100 per cent from USD26.5 billion in 2007, and its outflows continued to grow in 2009. The country currently ranks 13th in the world as a source of FDI and third among all developing and transition economies.[3] FDI outflow from India was USD18.8 billion in 2008, slightly less than the USD21.4 billion in 2007. Among the "BRIC" countries (Brazil, Russia, India and China), China's and India's OFDI also showed continuous growth. From 2004 to 2008, China's OFDI annual average growth rate was 81 per cent, while India's was 87 per cent, far ahead of the OFDI growth of Brazil (35 per cent) and Russia (68 per cent), although from a much lower base.

The outward FDI expansion of China and India has also been reflected in their growing levels of overseas mergers and acquisitions (M&As). In past years, firms from China and India have been actively involved in M&As, which are believed to be a less risky mode of entry into developed markets and an important means of accessing overseas assets urgently required for their global expansion. Chinese steel companies, such as state-owned Baosteel and Sinosteel and privately-owned Shagang, have been actively investing abroad in iron ore mining to secure supplies. While Indian conglomerates have been involved in mega deals, many medium-sized enterprises have also been undertaking M&As in developed regions. Thus, between 2000 and 2006, the value of cross-border M&As by Chinese firms increased greatly from USD0.5 billion to USD15 billion, while that by Indian firms increased from USD0.91 billion to USD4.7 billion.[4]

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1 UNCTAD, *World Investment Report*, 2009.

2 Ibid.

3 Ibid.

4 UNCTAD, FDI database, 2008.

Though the OFDI expansion by China and India has generated considerable interest and concern, few empirical studies have been conducted to compare the different incentives, structures and consequences of the OFDI. Most studies of OFDI related to these two countries have focused on the two countries as individual investors, instead of being comparative studies. For example, Buckley *et al.* found that "capital market imperfections" mainly account for the ease with which both natural resources-seeking FDI (typically in energy and raw materials sectors) and strategic asset-seeking FDI might be taken by Chinese TNCs.[5] Indian firms draw on the international experience of their parental and global networks to build capabilities for international operations. This support, in the form of parental networks (strategic networks) can be seen as a critical resource for a firm, as it reduces search costs, transaction costs, contracting costs, ambiguities, moral hazards and opportunism.[6]

This paper discusses the development process of China's and India's OFDI since the early 1980s, comparing the major driving factors and different investment structures of their TNCs. It uses the most recent data for both countries' actual OFDI flows. China's OFDI is mainly government-led, while India's is primarily driven by markets and private companies. As mentioned above, previous studies have found that "cheap capital" and "family networks" are the main respective determinants of China's and India's OFDI expansion. This paper tries to test and find the significant importance of the technology features of both countries' enterprises.

China's and India's Outward Investment Drive

China began its OFDI in the early 1980s. Prior to the 1990s, the development of China's OFDI fluctuated and was greatly surpassed by its net inward FDI (see Figure 1). During this period, as China's market-oriented reforms and opening-up process were accelerated, enterprises obtained greater operational

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5 "Capital market imperfections" means that capital is available at below market rates for a considerable period of time, creating a semi-permanent disequilibrium in the capital market that (potential) outward investors can exploit. See Peter J. Buckley, L. Jeremy Clegg *et al.*, "The Determinants of Chinese Outward Foreign Direct Investment", *Journal of International Business Studies* 38 (2007): 499–518.

6 B. Elango and Chinmay Pattnaik, "Building Capabilities for International Operations through Networks: A Study of Indian Firms", *Journal of International Business Studies* 38 (2007): 541–55.

autonomy. Those companies (mainly state-owned companies) which had achieved a leading edge in some sectors began to deliberately increase their investment abroad so as to expand their market space. But by this time, the OFDI behaviours of these enterprises had not yet been incorporated into their long-term production and business development strategies. They still lacked clear investment objectives and strategic intentions.

It was not until the early 2000s that China's OFDI began to grow steadily. The past industrialisation and developmental processes had substantially improved China's investment capabilities and skills (general, technical and managerial), physical and scientific infrastructure and institutions. A large number of enterprises, including private, foreign and joint-stock enterprises developed and became more mature, making OFDI a strategic need for these enterprises to expand their production and market space. Moreover, China became a WTO member in 2001, thus creating a more open and transparent international environment for its enterprises to go abroad. As shown in Figure 1, China's OFDI increased from USD2.5 billion in 2002 to USD53.8 billion in 2008, at an average annual growth rate of 64.5 per cent, surpassing that of its net inward FDI.

Based on the nature and character of cross-border production activities undertaken by Indian enterprises, the evolution of OFDI from India can also be divided into two periods: pre-1990 and from 1991 to the present. Although Indian companies have been investing overseas for decades, India's OFDI was quite limited in the pre-1990s period. Its OFDI during those years was characterised by small volumes and being family-company driven. According to UNCTAD, India's OFDI stock in 1986 stood at USD90 million, while China's amounted to USD1,350 million. For other developing countries like Brazil, it was USD39,583 million, Taiwan had USD13,336 million, Hong Kong had USD3,441 million, Malaysia had USD1,527 million, Singapore had USD1,473 million and South Korea had USD619 million.[7]

There are various factors that explain why the volumes of India's OFDI during this period were low. First, restrictive government policies such as the Monopolies and Restrictive Trade Practices Act, the Foreign Exchange Regulation Act, and other licensing regulation and reservation policies for public-owned and small sectors have restricted the scope and potential of overseas investment by Indian firms. For prudential reasons, the regulatory

[7] UNCTAD, FDI database, 2008.

regime not only required prior permission for OFDI, but also imposed limits both on the size of an OFDI project and the percentage of Indian ownership.

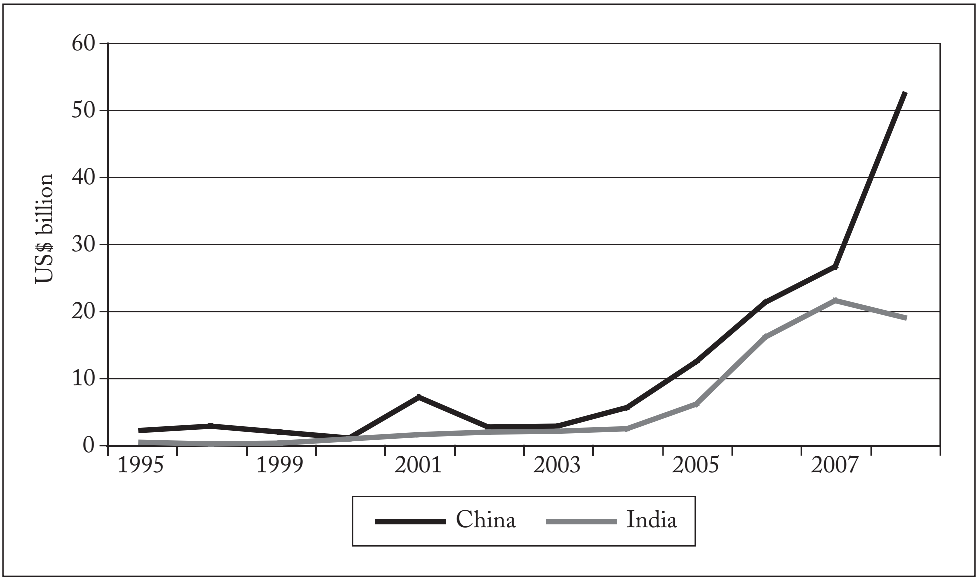
Second, the low levels of export activities by Indian firms in the pre-1991 period also reduced the scope of Indian OFDI. The protective policy environment pursued during that period assured Indian firms a large sheltered domestic market, thus negatively affecting their export incentives. A lower degree of export dependence implies that the need to undertake trade-related OFDI by Indian firms to support their exports is also low.

Indian firms began a new wave of OFDI expansion into developed parts of the world in 1991. The economic liberalisation process, which occurred from the early 1990s, provided strong impetus to Indian firms' advance abroad. The dismantling of tariff and non-tariff barriers to imports and provision of easier entry for foreign firms into Indian markets in the 1990s contributed to intense competition in domestic markets. These competitive pressures led to a turning point in the outward orientation of Indian firms and OFDI emerged as a preferred strategy for survival. The motivation of OFDI has also undergone significant changes in the 1990s. It has seen rapid change from mere market access and natural resources-seeking to trade-supporting and strategic asset-seeking. Indian firms realised that the market cannot be local under a globalised policy regime and that their survival would depend on their ability to capitalise on the opportunities offered by a global market. OFDI has emerged as a strategic business decision to be used to overcome constraints from limited home market growth, and to survive in an increasingly competitive business environment. Thus, while net FDI inflows have risen steadily in India since the initiation of reforms in 1991, gross investment outflows have also grown steadily especially after 2000. India's OFDI value in 2008 rose to USD18.8 billion, or about 25 times its value in 2000 (see Figure 1).

Major Drivers behind China's and India's OFDI

China and India initiated their OFDI in the early 1980s and their expansion accelerated from the early 2000s. The rising flows from these two major economies have been fuelled by their high economic growth, rapid accumulation of foreign currency reserves, and more fundamentally, the increasing competitiveness of the firms.

Figure 1. *China and India's OFDI*



Source: China Ministry of Commerce; Reserve Bank of India; data for India pertain to financial year (April–March)

Rising Economic Clout

In recent decades, the world has witnessed the astonishing economic growth of China and India. From 2000 to 2009, the average real GDP growth rate was 10 per cent in China and 7.2 per cent in India. The Asian Development Bank (ADB) placed China's 2009 purchasing power parity adjusted GDP per capita at USD6,914 (USD2,348 in 2000) and India's at USD3,287 (USD1,520 in 2000).[8] Economic liberalisation reforms undertaken by both countries have played an important role in triggering these high growth rates and rising economic clout. In recent years, FDI and international trade have greatly expanded in these two countries. China's net inflows of FDI to GDP ratio increased from 3.2 per cent in 2000 to 3.4 per cent in 2008; India's net inflows of FDI to GDP ratio increased from 0.8 per cent to 3.1 per cent. China's trade to GDP ratio increased from 38 per cent in 1995 to 60 per cent in 2008; India's trade to GDP ratio increased from 21 per cent to 42 per cent.[9]

8 ADB, *Key Indicators for Asia and the Pacific*, 2010.

9 Ibid.

In the past, China pursued a trade expansion policy focussing on manufacturing products, despite being positioned at the lower end of the international supply chain and producing predominantly labour-intensive goods. China's trade and capital "twin surpluses" led to the accumulation of more foreign reserves over the years. The Chinese central bank announced that its foreign exchange reserves surged through the USD2,000 billion mark at the end of June 2009, reaching USD2,130 billion. India, in contrast, has focused on trade in services. With its pool of low-cost, educated, English-speaking labour, India, like China before with manufactured goods, also grabbed the opportunity of globalisation and successfully inserted itself into the service supply chain. As a result, the service sector has experienced extraordinary growth and accounts for about one-third of total exports. Many Indian firms are cash-rich with strong balance sheets and are able to make new acquisitions globally.

Although India's current account balance remained generally negative in recent years, thanks to its healthy financial systems and continuous inflows of foreign investment, its capital account has maintained a primarily positive external balance since the early 1990s, thus also indirectly contributing to the accumulation of foreign reserves over the years. According to Asian Development Bank (ADB) data, by the end of 2009, China's foreign exchange reserves had risen to USD2,426 billion from USD169 billion in 2000, while those of India had risen to USD274.7 billion from USD40 billion in 2000.[10]

With increasing foreign reserves, both countries have had the capability and incentive to venture and invest abroad. To seek safe investment returns for these reserves, Beijing has purchased more and more US treasury bills, financing the US trade and budget "twin deficits", and in the process, eventually becoming the largest creditor of the US.[11]

In China, proactive fiscal policy responses to sustain economic growth in 2009, such as the USD580 billion stimulus package, as well as the expansionist monetary policy, helped maintain Chinese investors' confidence and FDI outflows at a high level. To further encourage Chinese enterprises to go out into the world, the Chinese government streamlined the procedures for

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[10] Ibid.

[11] As of October 2010, China held USD906.8 billion of US treasury securities, accounting for 21 per cent of the total (USD4,310.2 billion). See US Department of the Treasury/ Federal Reserve Board, Major Foreign Holders of Treasury Securities, at <http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/mfh.txt> [4 Jan. 2011].

approval of OFDI projects and planned to set up an oil stabilisation fund to support the purchases of overseas resources by Chinese oil companies. “China must diversify its assets and utilise its USD2 trillion reserve to seize the opportunities brought by the current financial crisis for more energy and resources deals”.[12]

With its growing foreign reserves, India has also introduced a number of new measures and proactive policies aimed at encouraging or supporting its OFDI. For instance, like China, India is planning to establish a multibillion-dollar sovereign wealth fund (SWF) to invest in energy assets abroad.[13] The Reserve Bank of India has increased the overseas investment limits on Indian companies from 300 per cent of the net worth to 400 per cent for wholly-owned Indian subsidiaries abroad.[14] The main objectives of such measures have been to increase the strength and competitiveness of its firms, and to secure access to natural resources and product markets overseas.

Energy and Resources Seeking

China and India are two emerging economic powers. As consumption power increases and lifestyles improve, Chinese and Indian consumers are buying more automobiles, electronic products and small household electrical appliances. At the same time, both countries, especially India, are building key infrastructure such as schools, roads and power plants. These changes in the social and economic sectors need more energy and resources. As China and India do not have abundant natural resources, the two countries must depend on and increase imports of oil, iron, copper and other raw materials to maintain their rapid development, thus dramatically increasing their expenditures on the imports of resources these years.

Take the consumption of oil, iron ore and non-ferrous metals as examples. China’s oil import dependence increased from 30 per cent in 2000 to 50 per cent in 2008, and will further increase to 74 per cent by 2030.[15] China became the world’s largest iron ore import country in 2003, and its import

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12 Wenran Jiang, “China Tries to Wriggle Out of the US Dollar Trap”, *YaleGlobal*, 29 Apr. 2009, at <http://yaleglobal.yale.edu/article.print?id=12311> [17 July 2009].

13 “Indian Plans Sovereign Wealth Fund for Energy Assets Abroad”, *The Economic Times*, 20 Feb. 2008.

14 Reserve Bank of India, *Annual Report 2008–2009*, at <http://rbi.org.in/scripts/AnnualReportPublications.aspx> [27 Aug. 2009].

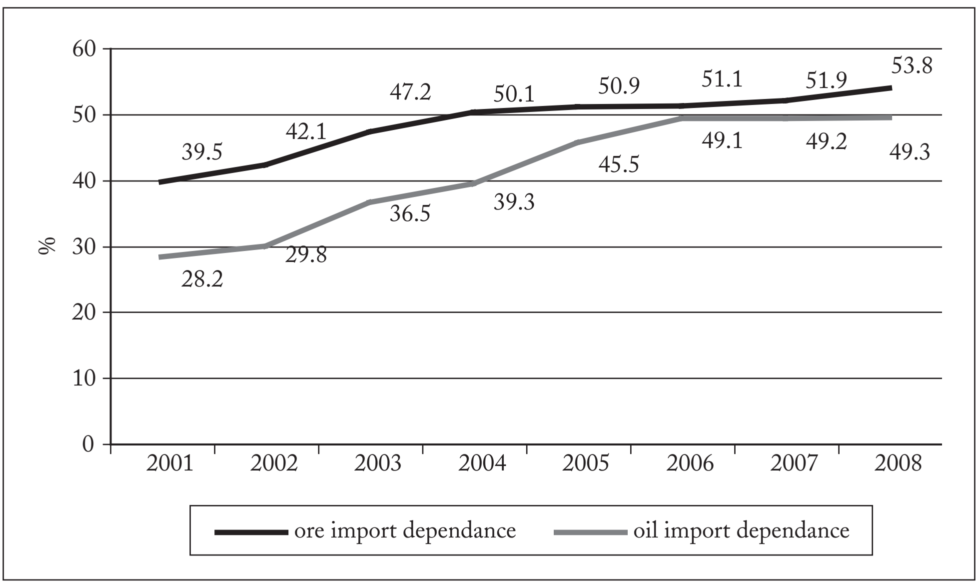
15 Oil dependence = net oil import ÷ total oil consumption.

dependence increased from 42 per cent in 2002 to 54 per cent in 2008 (see Figure 2). In terms of non-ferrous metals, according to the China *Economic Yearbook* (2002–2008), its trade deficit has been widening, rising sharply from USD4.9 billion in 2001 to USD34.7 billion in 2007.

The situation is roughly the same in India. According to the International Energy Agency (IEA), its oil import dependence reached 72 per cent in 2008, and is projected to reach 92 per cent by 2030.[16] The data from the Reserve Bank of India shows that India's oil trade deficit rose to USD54.8 billion in 2007–2008, compared with USD13.8 billion in 2000–2001, a threefold increase. The value of India's imports of non-ferrous metals and ores also rose sharply from USD0.35 billion and USD0.77 billion, respectively, in 2000–2001 to USD3.5 billion and USD8 billion, respectively, in 2007–2008 (see Figure 3).[17]

As the international production and supply of these strategic resources are mostly controlled and monopolised by a few giants, China and India are

Figure 2. *China's Oil And Ore Import Dependence*

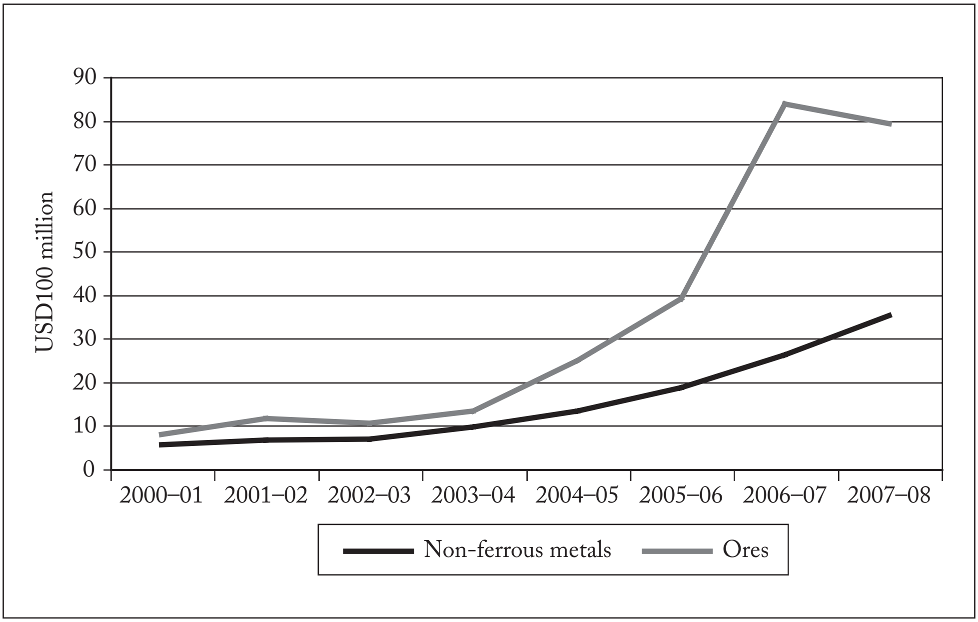


Note: Import dependence = total import/total consumption.

[16] International Energy Agency, *World Energy Outlook 2009* (Paris: IEA, 2006).

[17] Reserve Bank of India, *Handbook of Statistics on Indian Economy,* 2007/2008.

Figure 3. *India's Imports of Non-ferrous Metals And Ores*



Source: Reserve Bank of India, *Handbook of Statistics on Indian Economy 2007/2008*.

often in a disadvantaged and passive position when it comes to buying and importing them.[18] Furthermore, the international market prices of these strategic resources are badly affected by global financial market volatility, speculation and changes in ocean freight rates. Given the geopolitical importance of these resources, it has become an inevitable choice for Chinese and Indian energy companies to enhance their influence over production control and price-making for such strategic resources through approaches like joint ventures, acquisitions, or shareholding of overseas resources exploration. Chinese enterprises are indeed encouraged to enhance their presence overseas and cooperate with international firms in the world energy and resources markets. Chinese Premier Wen Jiabao recently said that "we should hasten the implementation of our 'going out' strategy and combine the utilisation of foreign exchange reserves with the 'going out' of our enterprises".[19]

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18 For example, Brazil's Vale do Rio Doce, and Australia's Rio Tinto and BHP Billiton control more than 70 per cent of global iron ore resources.

19 *Financial Times*, 22 July 2009.

Knowledge-Seeking FDI

Before their economic reforms, China and India had similar economic structures characterised by a large public sector and heavy dependence on agriculture. When they opened up their economies in the 1980s and 1990s, "changing externalities made it impossible for the two countries to emulate the successful proactive trade, industrial and technology-upgrading policies pursued by Japan and the Republic of Korea, which nurtured and protected their domestic enterprises before the latter entered the global market to compete".[20] As their economies embrace a globalising world, China and India must find alternative ways to nurture and enhance the competitiveness of their enterprises.

For many latercomers and technologically backward firms, OFDI in the form of overseas M&As provides an important means to access advanced proprietary technology, immobile strategic assets (such as brands and local distribution networks) and other capability mandatory for survival and growth in a globalising world economy. In fact, many Chinese and Indian firms engaged in overseas M&As were motivated to acquire skills, technology and widen the distribution networks overseas apart from the objective of accessing overseas markets. By associating themselves with a top brand name or product, Chinese and Indian companies can quickly raise their international profile as well as gain instant access to new markets. When Tata Steel acquired NatSteel Asia in 2005, Mr Ratan Tasta, chairman of Tata Steel, said that "the acquisition of the steel business of NatSteel Asia is an important step in Tata Steel's plans to build a global business. NatSteel's business provides Tata Steel access to key Asian steel markets including China".[21]

China and India need to develop their own competitive companies to compete with international multinational companies. China's strategy is to create between 30 and 50 internationally competitive firms, especially in "pillar industries", which can compete with the world's leading corporations. The "going out" strategy has been an effective approach to realise this goal as it has enabled Chinese companies to gain access to technology and bring their operations in line with international standards. Thus, an increasing number of

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[20] Yuefen Li and Bin Zhang, "Development Path of China and India and the Challenges for their Sustainable Growth", *The World Economy* 31, no. 10 (2008).

[21] Quoted from Jaya Prakash Pradhan, "India's Emerging Multinationals in Developed Region", MPRA Paper No. 12361, Dec. 2008, at <http://mpra.ub.uni-muenchen.de/12361/> [17 July 2009].

Chinese as well as Indian domestic enterprises are using OFDI as a tool to enhance international competitiveness, and become multinationals by acquiring foreign companies, manufacturing facilities and brands. Some of the Chinese and Indian firms are now among the world's most respected due to their rapid internationalisation and growing role in world business.

OFDI Structures of China and India

Apart from some of the above similarities, China's and India's OFDI also exhibit some significant differences in terms of investment areas, sectors and capital sources.

Investment Areas are Different

According to data released by China's Ministry of Commerce in 2010, China's OFDI extends to over 150 countries, and within each, tends to be geographically concentrated. Table 1 shows that by the end of 2009, Asia accounted for 75.5 per cent (of which Hong Kong alone took 88.2 per cent in this figure), Latin America for 12.4 per cent and Africa for 3.8 per cent of the OFDI stock, while the European and North American shares together accounted for only 5.6 per cent. However, China's FDI in these two regions in 2009 and 2010 expanded as these economies gradually recovered.

Table 1. *Regional Share of China's OFDI (%)*

Region	2003	2004	2005	2006	2007	2008	2009	Stock by 2010
Europe	5.3	3.1	4.2	3.4	5.8	1.6	5.9	3.5
North America	2	2.3	2.6	1.5	4.3	0.65	2.9	2.1
Oceania	1.1	2.2	1.7	0.8	2.9	3.5	4.4	2.6
Asia	52.5	54.6	35.6	43.4	62.6	77.9	71.5	75.5
Latin America	36.5	32	52.6	48	18.5	6.6	13.0	12.4
Africa	2.6	5.8	3.3	2.9	5.9	9.8	2.5	3.8
Total	100	100	100	100	100	100	100	100

Source: Based on data from National Bureau of China, *China Statistical Yearbooks,* 2004–2009.

The fact that Asia accounts for most of China's OFDI is due to the role of Hong Kong and China's increasingly close economic relations with

Southeast Asia. The investment of China in Hong Kong and in tax havens reflects the phenomenon of "round-tripping", whereby funds are moved abroad to take advantage of beneficial conditions in the host country, and then reinvested in China to benefit from the advantageous terms for foreign investors.[22] Alternatively, these flows may also establish holding companies in these countries for investment elsewhere, particularly in Hong Kong, because these locations give them convenient access to trade and financing opportunities.[23]

The China-ASEAN Free Trade Area (FTA) Agreement was implemented in January 2010. On 16 August 2009, China fulfilled its promise by signing the ASEAN-China Investment Agreement with a USD15 billion loan to assist Southeast Asian countries in the upgrading of transport and telecommunications infrastructure. It also agreed to provide another USD10 billion in the form of an emergency investment fund to help ASEAN countries cope with their future economic problems. For individual countries, the value of Chinese investment reached USD174 million in Indonesia in 2008, USD1,551 million in Singapore, USD120 million in Vietnam and USD45 million in Thailand.[24] China is likely to become the largest foreign investor in Southeast Asia in the near future as it is currently the eighth largest investor in ASEAN.

Another important reason for China's rapidly increasing investment in developing countries is the fact that the nature of China's OFDI can definitely benefit less developed countries. Like other developing countries' OFDI, China's OFDI brings in intermediate technologies which are suitable to the needs of and conditions in the less developed countries. Moreover, the cost of technology transfer is relatively low compared to that of the firms from developed countries. Also, the technology contracts are generally not embedded with restrictive clauses that characterise technology transfer from developed countries, such as export restrictions, inputs and raw materials

22 China's investments in Latin America are mainly concentrated in some tax havens like the Cayman Islands and Virgin Islands. By the end of 2008, these two areas together accounted for 16.5 per cent of China's stock OFDI, and 95.5 per cent in China's stock OFDI in Latin America.

23 Randall Morck and Bernard Yeung, "Perspectives on China's Outward Foreign Direct Investment", *Journal of International Business Studies* 39 (2008): 337–50.

24 China National Bureau of Statistics, *China Statistical Yearbook*, 2009, p. 752.

sourcing requirements, restrictions on reverse engineering, etc. In recent years, China's OFDI has mainly flowed to its neighbouring countries, and increasingly to Africa, Latin America and other developing countries. This aligns with the "technology localisation theory", according to which, "outward FDI from developing countries' enterprises tends to flow to those countries or regions which are of the similar development levels".[25]

Prior to the 1990s, India's OFDI flows were largely limited to its neighbouring (developing) countries and were dominated by a few manufacturing sectors. Such investments were viewed by the Indian government as its contribution to "south-south" cooperation.[26] During the 1980s, the share of India's total OFDI going to developed countries stood at 76 per cent. However, this changed in the early 1990s. The share destined for developed countries rose continuously from 24 per cent in the 1980s to 44 per cent in the 1990s, and climbed further to 64 per cent in 2000–2007 (see Table 2).

The sharp rise in India's OFDI into developed regions has also been reflected in its overseas M&As. During the period from 2000 to March 2008, Indian FDI flows into developed countries in the form of acquisitions stood at USD47.4 billion, accounting for 80 per cent of the total acquisitions made by Indian companies (see Table 3). There were a total of 306 Indian firms engaged in acquisitions covering 28 developed countries. Strong sales growth, increased corporate profits and capability to raise international resources for M&As all contributed to the rising phenomena of overseas acquisitions by Indian firms.

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[25] According to the "theory of localised technological changes", transnational corporations from developing countries typically share small-scale, standardised and labour-intensive technologies. These technologies are more suitable to domestic markets and markets with similar levels of national income and economic development. See Sanjaya Lall *et al.*, *The New Multinationals: The Spread of Third World Enterprises* (Chichester: J. Wiley, 1983).

[26] Jaya Prakash Pradhan, "Growth of Indian Multinationals in the World Economy", Institute for Studies in Industrial Development, MPRA Paper No. 12360, Dec. 2008, at <http://mpra.ub.uni-muenchen.de/12360/> [17 July 2009].

Table 2. *Regional Share of Indian OFDI*

Period	Percentage Share (%)			No. of OFDI Firms			No. of Host Countries		
	Developing	Developed	Total	Developing	Developed	Total	Developing	Developed	Total
1980–1989	76.3	23.7	100	106	55	146	29	9	38
1990–1999	56.4	43.6	100	692	687	1,257	61	27	88
2000–2007	36	64	100	1,012	1,327	2,104	78	28	106
All years	38.8	61.2	100	1,674	1,866	3,149	92	30	122

Note: Developed region includes countries classified as developed by the UNCTAD in *World Investment Report* 2006.
Source: Jaya Prakash Pradhan, "Indian Direct Investment in Developing Countries: Emerging Trends and Development Impacts", at <http://mpra.ub.uni-muenchen.de/12323/> [17 July 2009].

Table 3. *India's Acquisitions in Developed Regions, 2000–2008*

Year	Value (USD million)	As a percentage of total Indian Acquisition	Acquisition Deals	Acquiring Indian Firms	Host Developed Countries
2000	887	97.7	35	27	6
2001	172	88.6	20	19	5
2002	118	4.6	19	14	5
2003	594	96.6	34	31	8
2004	785	26.1	42	38	10
2005	2,518	61.8	108	85	18
2006	5,976	77.6	151	114	23
2007	33,739	91.2	144	118	21
2008	2,614	71.9	43	42	12
2000–2008	47,402	79.3	596	306	28

Source: Jaya Prakash Pradhan, "India's Emerging Multinationals in Developed Region", Institute for Studies in Industrial Development, MPRA Paper No. 12361, Dec. 2008, at <http://mpra.ub.uni-muenchen.de/12361/> [17 July 2009].

The growing importance of developed countries as a host to Indian OFDI can be attributed to the emergence of the knowledge-based segment of the Indian economy, including industries such as drugs and pharmaceuticals and software development.[27] In the 1980s, India made much technological progress in pharmaceuticals, automobiles and information technologies. The maturing technological strength of these large-sized Indian firms enabled them to exploit their competitiveness and advantages in developed countries. In the case of pharmaceuticals, Indian companies have been attempting to seek new unregulated markets for their generic drugs, while also looking to acquire facilities that already have regulatory clearance in regulated markets such as the US and Western Europe. In the case of software development, since much of the software activities require proximity to their customers in developed countries, Indian software firms use OFDI to establish their fully-controlled branches or subsidiaries abroad to acquire overseas competitors for gaining market access and additional intangible assets. Hence, from the 1990s, developed countries began to emerge as attractive destinations for Indian OFDI. In theory, the

27 Jaya Prakash Pradhan, "Outward Foreign Direct Investment from India: Recent Trends and Patterns", Gujarat Institute of Development Research, MPRA Paper No. 12358, 2008, at <http://mpra.ub.uni-muenchen.de/12358/> [17 July 2009].

overall development path of Indian OFDI more or less follows the evolution law of "neighbouring countries–other developing countries–developed countries" which was proposed by the "technological innovation upgrading theory".[28]

Investment Sectors are Different

In terms of sectoral share of OFDI, non-financial service and mining sectors accounted for the largest shares of Chinese OFDI, while manufacturing accounted for a relatively small share. In 2008 and 2009, non-financial services accounted for 57.2 per cent and 56.5 per cent, respectively, mining accounted for 10.4 per cent and 23.6 per cent respectively, while manufacturing accounted for 3.2 per cent and 4 per cent, respectively (see Table 4). In non-financial

Table 4. *Sectoral Share of China's OFDI (%)*

Industry	2003	2004	2005	2006	2007	2008	2009	Stock by 2009
Mining	48	32.7	13.7	40.4	15.3	10.4	23.6	16.5
Manufacturing	21	13.8	18.6	4.3	8	3.2	4.0	5.5
Financial services	–	–	–	16.7	6.3	25.1	15.5	18.7
Non-financial services	28	48.2	67.7	37.7	69.4	57.2	56.5	58.6
Leasing and business services	10	13.6	40.3	21.4	21.2	38.8	36.2	29.7
Wholesale & retail	13	14.5	18.4	5.2	24.9	11.7	10.9	14.5
Transportation & storage	3	15.1	4.7	6.5	15.4	4.8	3.7	6.8
Building & real estate	1	–	–	1.8	4.6	1.9	2.3	3.7
Other services	1	5	4.3	2.8	3.3	3.1	3.4	3.9
Others	3	5.3	0	0	1	1	1	1
Total	100	100	100	100	100	100	100	100

Source: China National Bureau of Statistics, *China Statistical Yearbooks*, 2003–2009.
Note: Other services include hotels and catering services, scientific research and technical services.

28 The "theory of industrial upgrading and technological innovation" holds that the development of technology capabilities of developing countries is an ongoing incremental process which eventually leads to their industrial structural upgrading and some absolute advantages in certain technology areas. It is these absolute advantages that determine and promote their outward FDI. Thus, the evolution law of OFDI from developing countries is: neighbouring countries, followed by other developing countries, then developed countries. See John A. Cantwell and Paz Estrelia Tolentino, *Technological Accumulation and Third World Multinationals* (Reading: University of Reading, 1990).

services, most went to business services, wholesale and retail, and transportation and storage which are closely related to foreign trade. This indicates that "trade-oriented" investment is one of the characteristics of Chinese firms' OFDI.

The current global economic crisis has provided China with a rare opportunity to trade its abundant foreign currency reserves for oil, minerals and other resources around the world. Chinese state-owned enterprises (SOEs) have been encouraged to make acquisitions by the central government which is convinced that the global financial crisis has created an unmatched buying opportunity. They are taking advantage of depressed asset prices and access to Chinese credit to strike deals across the globe. These deals are designed to secure the resources needed to power China's growing economy. Nearly all overseas M&As announced by Chinese companies in 2009 were in mining or energy. For instance, in June 2009, Sinopec (China Petroleum and Chemical Corporation) moved into the booming oil frontier of Iraqi Kurdistan by agreeing to a USD7.2 billion takeover of Addax Petroleum Corp, making it the largest Chinese overseas acquisition to date.[29] In the same month, China Investment Corporation, the country's USD200 billion sovereign wealth fund, agreed to pay CD1.74 billion for 17.2 per cent stake in Teck Resources, a Canadian zinc and copper mining company.[30] These deals demonstrate a growing confidence among Chinese energy companies. They are gradually growing into international oil companies, capable of striking high-profile and cross-border deals in a more public manner. They are even expanding into countries such as Iraq and Syria, deemed too risky by Western oil companies.

In the case of India, it is evident that manufacturing is the major sector in its OFDI. Table 5 shows that in 2008–2009, manufacturing accounted for nearly half of India's total OFDI. This can be explained by two major factors: the Indian manufacturing sector has been growing at a healthy rate in the last half decade supported by the parental networks in Western countries. Many of the Indian family-run companies have been involved in outward ventures far longer than their Chinese counterparts. They have developed the requisite knowledge and business acumen to deal with the complex issues relating to

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29 The Sinopec-Addax transaction, if finalised, will greatly help Sinopec reduce its dependence on buying crude oil for its vast network of refineries and gasoline stations. More importantly, it will increase Sinopec's presence in one of the world's hottest oil-exploration frontiers — offshore West Africa, and oil-rich but politically sensitive Iraqi Kurdistan, *The Wall Street Journal*, 25 June 2009.

30 *Financial Times*, 20 June 2009.

Table 5. *Sectoral Share of India's OFDI (USD million; %)*

Industry	2003–2004	2004–2005	2005–2006	2006–2007	2007–2008	2008–2009
Manufacturing	893 (60)	1,170 (65.9)	3,407 (67.5)	4,185 (30)	5,409 (28.9)	8,096 (48)
Financial services	1 (0.07)	7 (0.4)	160 (3.3)	28 (2)	88 (0.47)	143 (0.85)
Non-financial services	456 (30.5)	304 (17.1)	895 (17.7)	7,527 (54)	1,748 (9.3)	1,154 (6.9)
Trading	113 (7.6)	192 (10.8)	377 (7.5)	659 (4.7)	1,050 (5.6)	937 (5.6)
Others	31 (2.1)	100 (5.6)	207 (4.1)	1,499 (10.8)	10,435 (55.7)	6,450 (38.4)
Total	1494 (100)	1,776 (100)	5,050 (100)	13,898 (100)	18,730 (100)	16,780 (100)

Source: Reserve Bank of India, *Indian Annual Reports* (2007–2008, 2008–2009) at <http://rbi.org.in/scripts/annualreportpublications.aspx> [27 Aug. 2009].
Note: Others include mining and agriculture.

the management of cross-border alliances. The figures in Table 5 also suggest that Indian OFDI in the mining sector has been rising.

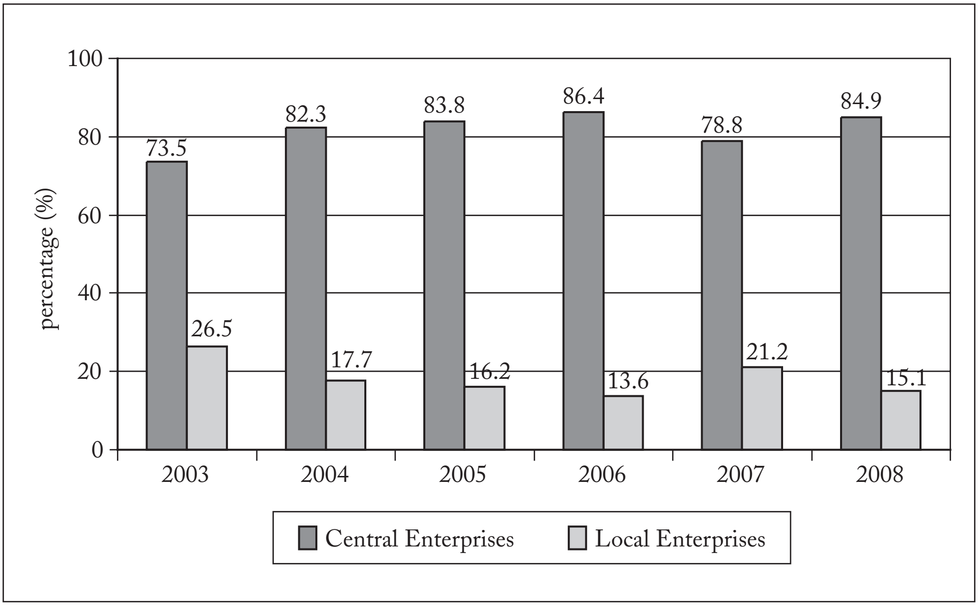
Differing Main Components of OFDI

In terms of the components of OFDI sources, the Chinese central enterprises (including state-owned enterprises and state-owned capital-holding enterprises) are prominent in China's OFDI. In 2008, these central enterprises accounted for 85 per cent of China's total OFDI, while local enterprises (including private enterprises) accounted for 15 per cent (see Figure 4).[31]

This explains the fact that Chinese local and private enterprises still lack sufficient capital and technology capabilities to invest abroad. It also shows that a priority in the Chinese OFDI strategy has been to secure access to those strategic assets and natural resources by supporting large state-owned enterprises to invest abroad. Clearly, at a broader level, China has used its OFDI to enhance its foreign policy objectives by becoming involved in political risky countries. It has been able to wield its "soft power" very

[31] But this appears to be gradually declining and is likely to be an overestimate because private-sector OFDI is less likely to go through official procedures.

Figure 4. *Components of China's Outward FDI Sources*



Source: China' Commerce Ministry, *Statistics of China's Outward FDI* (2003–08).

effectively as the investments are generally driven by state-owned enterprises. This might also partially explain the fact that China's OFDI expansion has not been affected adversely by the current global financial crisis.

Unlike state-driven Chinese FDI outflows, Indian OFDI has been primarily led by some leading Indian multinationals owned by large Indian business houses and driven by markets with little coordination with the government, except a few public sector firms operating in the energy sector such as ONGC, Oil India and Hindustan Petroleum Corporation Limited. To avoid the increasingly intense domestic market competition and restrictions, domestic Indian firms of all sizes spontaneously resorted to OFDI as a means of survival and growth in a globalised business environment. For those Indian firms which have improved their investment advantages by innovating cost-reducing processes and undertaking research and development (R&D) expenses for product development, quality and skill improvements, OFDI came as a natural choice for them to become a multinational entity. In this sense, Indian OFDI is driven fundamentally by inherent incentives and innovations, global growth, competition and business opportunities. Thus, it is not surprising to see that Indian OFDI was affected and shrank when market conditions turned adverse in 2008.[32] A number of Indian companies such as Sakthi Sugars, Reliance Industries, Vardhman Polytex, Wockhardt, and Suzlon Energy are closing or disinvesting from some of their overseas subsidiaries due to the economic meltdown in 2009.

Conclusion

In sum, while China's OFDI is mainly government-led, India's is primarily driven by markets and private companies. The internationalisation thrust of Chinese enterprises has been more top-down, meaning their investment decisions reflect political objectives, not just profit-maximisation as in the case of privately-owned multinationals from India. The approach of Indian enterprises has been more decentralised. Unlike China, India's OFDI is driven fundamentally by global growth, competition and business opportunities, so it is not surprising to find that the "going out" of its enterprises has been lagging behind China these years despite having a longer OFDI history than China. This is evidenced by a *Fortune* magazine report in 2009 which reported that over 30 Chinese enterprises have been listed among the Global Fortune 500, while only seven Indian enterprises have made the list.[33] With the government's support, some Chinese firms are now among the world's most respected as a result of their rapid internationalisation and growing importance in world business.

On the other hand, however, Chinese companies are hampered in their outward investment due to their government links and "image" factors. China's inevitable rise as a significant economic player has caused consternation by challenging the established order of industrial hegemony. China's overseas investment and the potential role of its sovereign wealth funds have stocked concerns that Beijing is manoeuvring to lock up global energy assets through its FDI expansion.[34] Critics also said that "China's energy quest and its record

32 As shown by Figure 1, Indian FDI outflows rose to a historic level of USD21.4 billion in 2007 and fell by 12.1 per cent in 2008 (by end March) to USD18.8 billion, contrasting with China's doubling of its OFDI from USD26.5 billion in 2007 to USD52.2 billion in 2008. The contracting in Indian OFDI continued in 2009, falling by 14 per cent to USD4.7 billion in the first quarter of the same year.

33 *Fortune China* at <http://www.fortunechina.com> [8 July 2009].

34 Concerns about sovereign wealth funds (SWF) have included the following ideas: the government may mismanage the funds, including paying insufficient attention to

in the world's trouble spots, from North Korea and Myanmar to Iraq and Darfur, suggest that it defines its responsibilities in ways that enhance its economic interest".[35]

Tensions between China's economic interests and local social obligations play out in Africa. Chinese firms tend to enter new markets in Africa by building new facilities, creating business entities that are vertically integrated, buying supplies from China rather than local markets, and selling in Africa mostly to government entities. They rarely facilitate the integration of their workers into the African socioeconomic fabric. For instance, in Angola, where Western companies rely primarily on local labour, Chinese companies bring 70 to 80 per cent of their labour from home.[36] Thus, it is not difficult to see that China's presence in the continent has generally been viewed as negative and has generated considerable resentment among Africans.[37]

Due to the government links, Chinese companies were also hampered politically in their mergers and acquisitions in the West as well as in India. What has already caused anxiety in some Western countries, particularly the US and Australia, is the fact that the leading Chinese companies, banks and investment funds are state-controlled.[38] These developed countries have

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corrupt practices; the government may manage the funds efficiently but for non-profit purposes; SWF decisions may lead to "financial turmoil" (as it was alleged of hedge funds). See Edwin Truman, "A Blueprint for Sovereign Wealth Fund Best Practices", Peterson Institute Policy Brief, PB08-3, April 2008.

35 David Barboza, "China's Sprint for the Gold", at <http://www.nytimes.com/2009/11/15/weekinreview/15barboza.html> [19 July 2010].

36 For example, while nearly 90 per cent of Chevron's workers are Angolan, including specialised personnel such as engineers and managers, Chinese oil companies employ fewer than 15 per cent Angolan labour. See "China in Africa: Soft Power, Hard Results", *YaleGlobal Online Magazine*, 13 Nov. 2009, at <http://yaleglobal.yale.edu/print/6059> [19 July 2010].

37 The Chinese government has been taking some positive steps to address this problem. For instance, China's state-backed Africa investment fund is seeking to break new ground by pushing Chinese companies to build infrastructure through joint ventures with African governments, as the proliferation of China-Africa business ties and the binding of the fortunes of its companies more closely with local communities would help China counter criticism that it is exploiting Africa.

38 In reality, state-owned firms in China are increasingly subject to the disciplines of the market at home. They have preferred access to domestic credit through the state-owned banking system but on terms that are increasingly commercially-based.

spent recent decades convincing their voters that the private sector, not the government, should take the lead in managing most businesses. They regard China's autocratic political system as incompatible with their own democratic norms, thus they do not want to let oil and gas assets fall into the hands of Chinese companies. CNOOC's unsuccessful acquisition of Unocal in 2005 was a result of fear that this deal would undermine US energy security when Unocal's production was channelled to China, and harming the US economy through replacement of Unocal's US employees with the Chinese.

The Rio Tinto case is another case in point. In early June 2009, Anglo-Australian mining giant Rio Tinto Ltd rejected Aluminum Corporation of China's USD19.5 billion offer for acquiring part of the company. That deal also faced economic, political and shareholder opposition, reflecting fears and concerns in Australia over the consequences of giving China direct access to big supplies of natural resources.[39] New Delhi also continues to be concerned about China's investment expansion in some strategic sectors, such as communication, energy and even infrastructure sectors, and has excluded some Chinese firms which are tied to the Chinese Communist Party from investment in this country. This has greatly restrained Chinese investment expansion in India.[40]

In the case of India, it is believed that "its liberal democratic regime type is a real advantage over China in the two Asian giants' competition for global attractiveness and influence".[41] "One remarkable thing about elite public

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[39] In Australia, there are two big concerns about the prospect of a significant rise in FDI from China into its resources sectors: is the surge of FDI into its mining and energy consistent with achieving the traditional gains from foreign investment? Are there any particular problems associated with investment from Chinese state-owned enterprises or state-managed sovereign wealth funds? Much of these concerns seem to relate to uncertainty about how to respond to the growth of Chinese investment in its resources and energy sector. Actually, the issues of state ownership, and other political or security matters are issues that cannot be appropriately dealt with by simply restricting Chinese or other countries' FDI proposals.

[40] According to Chinese statistics data, in 2008, China's FDI in India was only USD102 million (accumulated value USD222 million), accounting for only a very small part of China's total OFDI which reached USD559 million (accumulated value USD183,970 million).

[41] Joseph S. Nye, Jr., *Soft Power: The Means to Success in World Politics* (New York: Public Affairs, 2004), p. 89.

opinion in the US is that everybody likes India", "because they no longer see Indian foreign policy as effeminate, legalistic, and annoying; they now see it as muscular, realistic and cooperative".[42] This "new" image plus its market-driven investment have smoothed the way for India's overseas activities, leading to more investment flow to Western countries.

The above analysis also shows that China's and India's OFDI differ in terms of investment areas and sectors. China's OFDI mainly goes to developing countries and non-financial services, mining and infrastructure sectors, while India's mainly goes to developed countries and manufacturing sectors, including pharmaceuticals, gems and automotives parts. There is thus little conflict or competition between these two giants in the third markets.

By contrast, there is moderate complementarity in their OFDI structures and approaches. Many Indian companies have been involved in outward ventures far longer than their Chinese counterparts, and have developed the requisite knowledge and acumen to deal with the complex issues relating to the managing of cross-border alliances. Most Indian firms acquire established businesses, are less vertically integrated, preferring to procure supplies locally or from international markets (rather than from Indian suppliers), and engage in far more sales with local private entities, and also encourage the local integration of their workers into the African socioeconomic network. Whereas China has advantages in its government-led strategy and economic diplomacy, its "going out" approaches and overseas M&As, especially after the financial crisis, could be more assertive and efficient. This indicates a potential for both countries to learn from each other, and bilateral cooperation for their future FDI expansion.

It is inevitable that both Chinese and Indian enterprises may face some difficulties in their "going out" process, but they will continue to internationalise actively, and M&A activities will remain an active component of their overseas resource acquisition strategy. In the case of India, although its overseas activities have not encountered the political difficulties and challenges that China faces, its OFDI was adversely affected by the global and domestic slowdown in overall growth. The global financial crisis had a significantly negative impact on its financial sub-sectors like Indian equity, money and foreign-exchange markets, which have, in turn, restricted Indian firms' access to cheap sources

[42] Jacques E.C. Hymans, "India's Soft Power and Vulnerability", *India Review* 8, no. 3 (July–Sept. 2009).

of finance and reduced their capability to invest abroad. Nevertheless, both countries are adjusting their outward FDI approaches and strategies. The Indian government has introduced a number of new measures and proactive policies aimed at encouraging or supporting more of its enterprises to go out. The Chinese SOEs are learning to be more skilful and selective in their overseas acquisition of exploration and production assets. They believe that by partnering with the Western oil majors and experienced partners, they will be able to have a better chance to get deals overseas and enter into new territories. In sum, Chinese and Indian enterprises will further expand their global economic activities, and M&As will remain an important component of both countries' overseas resource acquisition strategy.