Foreign Acquisitions by Indian Multinational Enterprises: The Role of Source and Host Country Location Specific Determinants

Abstract

This experimental paper explains foreign acquisitions by Indian multinational enterprises by reference to location specific factors in both the source country (India) and host countries together with variables required designed to capture the distance between India and the host country, both geographic and psychic.

The paper finds that country specific advantages play an important role in explaining Indian foreign acquisitions. The general model performs well and Indian institutional and domestic capital variables add explanatory value.

Keywords: Multinational enterprises (MNEs); emerging-country multinationals (EMNEs); India; foreign direct investment (FDI) determinants; acquisitions.

11 July 2010: Version 7

Introduction

This is an experimental paper. It attempts to explain foreign acquisitions by Indian multinational enterprises (MNEs) by reference to location specific factors in the source (home) and host countries. Dunning (1998) has re-emphasised the importance of location variables and our analysis tests this contention. It seeks to measure the extent to which locational variables can explain foreign acquisitions. Our dependent variable is the value (and number) of foreign acquisitions by India firms 2000-2007. This is to be explained by location variables, examining the attraction of the host country by host and source country (India) variables and by a set of variables that describe the (physical, cultural and transaction cost) distance between India and the target country. Our experiment therefore might be taken as testing the extent to which country specific advantages (CSAs) (Rugman 1981, Rugman & Verbeke 1992) or macroeconomic determinants (Kojima 1973, 1975, 1978) explain foreign acquisitions.

This paper explores the source country specific attributes and host country specific location advantages that influence Indian multinationals making foreign acquisitions over the period 2000-2007. India has become the second fastest growing economy in the world after China in the last two decades. India has stood out among other developing countries of Asia not only because of recent significant increases in inflows of foreign direct investment (FDI) but also as a result of its potential to be a large outward investor (UNCTAD, 2004) current annual outflows average more than US$ 13 billion in recent years[i]. Internationalisation of Indian multinational firms (MNEs), historically undertaken through greenfield investments in the period that preceded gradual liberalisation of India's economy in 1991, has increasingly taken place through cross-border mergers and acquisitions (M&As) since the late 1990s (Ramamurti and Singh, 2008).

The nature, motives and trajectory of internationalisation pursued by Indian MNEs had been neglected but it has been investigated in some recent studies, prominently Pradhan (2007), Kumar

(2006) and Nayyer (2008). However, these studies are mainly descriptive due to the paucity and poor quality of the available disaggregated data. Using an exhaustive data set on foreign acquisitions by Indian MNEs from Thomson One Banker's over the period 2000 to 2007, this study is, to our knowledge, the first comprehensive attempt to model the determinants of FDI through foreign acquisitions by Indian MNEs. In this paper OFDI refers to acquisitions (acquisition of more than 10 percent of equity becomes FDI by definition). India provides a good case to test the general theoretical explanation of FDI.

General explanations of FDI especially the Eclectic Paradigm has been criticised on various grounds. The Eclectic Paradigm was developed in the context of success stories of resourceful Anglo American MNEs and therefore may not apply to the context of (often) resource-less emerging MNEs (Mathews 2006; Akyut 2006, and Bonaglia et al., 2006). However, we conjecture that Indian MNEs derive special advantages originating from source country characteristics, such as the opportunity to raise finance from domestic capital market, the appreciation of Indian Rupee against US Dollar, the proficiency of Indians over the English language, and policy liberalisation within Indian outward investment policy. We suggest that many Indian firms exploit these source country specific advantages in exploring foreign markets and acquiring advanced technology through foreign acquisitions.

Trend and pattern of foreign acquisitions

From the pre-liberalisation era until the beginning of 2001, Indian OFDI averaged less than $100million per year[ii]. However, policy changes in recent years have significantly increased OFDI activities, especially in 2003 when the absolute limit on OFDI was lifted. The average annual OFDI flow in the post-2003 period exceeded $15 billion per year. According to the Thomson One Banker dataset, Indian MNEs made 866 acquisitions of foreign firms, valued at $51 billion during the period 2000 to 2007.

The concentration of such acquisitions in highly competitive and mature markets such as the UK and the USA is striking; about 40 percent in number and 54 percent in total value of such acquisitions took place in these two countries alone. This pattern is in sharp contrast with the pre-liberalisation period when a similar proportion of Indian OFDI targeted less developed countries (Lall, 1983).

While developed countries may represent centres for knowledge assets for resource- and strategic asset-seeking FDI they also provide Indian MNEs with access to large and developed markets, marketing and distribution channels for well-established brands and wider product portfolios. In addition, developed-country markets are generally mature markets typically served by MNEs, and this may creates incentives for Indian firms to use acquisitions, as opposed to greenfield investments, as the preferred entry mode. The high costs and disruptive impact of new capacity make acquisition of existing firms the more attractive entry mode. The sectoral breakdown of these acquisitions also reveals the significance of the skill-intensive industries such as high-tech products (software in particular) as well as the industrial, chemical and healthcare industries, accounting all together for 52 percent of the number of acquisitions across the period. It is in all these aspects that Indian OFDI differs from that of other emerging countries such as China. While the established theoretical frameworks were developed in the context of OFDI by developed country firms, we examine their application to the context of OFDI by Indian MNEs. The next section introduces these frameworks.

Theoretical framework

This section briefly examines the general theory of FDI and attempts to identify source and host country-specific factors which may have enabled Indian MNEs to make foreign acquisitions.

General theoretical frameworks

Hymer first conceived the general theory of FDI in 1960, later work by Buckley and Casson (1976, 1985, and 2009), Rugman (1981, 1985, and 1996) and Dunning (1977, 1981) formalised the principles of FDI in the form of Eclectic Paradigm. Accordingly, FDI theory is based on the

foundation of imperfection, internalisation and locational factors. Structural or market imperfections lead to generation of advantages (Kalfadellis and Gray, 2002) and transaction costs (Williamson, 1981) provide the rationale for internalisation of activities by MNEs at foreign (advantageous) locations. The location aspect of FDI theory puts forwards four motives of FDI viz: market seeking, resource seeking, efficiency seeking and strategic- asset seeking. There can be other motives of FDI such as tax planning (Gurbert and Slemrod, 1998).

Rugman (1981, 2006) resolves the Ownership, Location and Internalization (OLI) configuration within the Eclectic Paradigm into firm specific advantages (FSAs) and country specific advantages (CSAs) where ownership advantage (O) can be firm specific or country specific (FSA or CSA), location (L) is a host country specific advantage (CSA) and internalisation (I) is a firm specific (FSA) factor.

In the Investment Development Path, the general theory envisages the role of inward FDI in promoting domestic economic growth (a home country macro economic factor) and through a series of continuous structural and institutional changes generate firm-specific ownership advantages at later stages of development, when firms learn by doing and consequently evolve into global firms (Dunning, 1981a, 1981b, 1986, 1993a; Dunning and Narula, 1996, Barry et al., 2003).

The Uppsala model (also known as the Stages model) of internationalisation emphasises the importance of cultural factors. Accordingly internationalisation takes place in stages with early investments happening in countries with a similar cultural background (Johanson and Vahlne, 1977, 2009) as transaction costs increases with cultural distance.

To measure cultural distance, Kogut and Singh (1988) developed an index based on Hofstede's (1980, 1983, 1991, 2003) empirical framework of national dimensions of culture. Hofstede's first four cultural dimensions are:

i. Power distance index (PDI) which signifies the extent of acceptance of the unequal distribution of power within organisations. It suggests that all societies are unequal; some more than others.
ii. Uncertainty avoidance index (UAI) refers to a society's tolerance for uncertainty. Some societies try more to minimise uncertainties and are more deterministic than others.
iii. Individualism (IDV) refers to a society's indifference towards integration, ties among individuals, strong cohesive groups, and the protection of others.
iv. Masculinity (MAS) refers to the importance of values such as assertiveness and competitiveness, as compared to more feminine traits such as caring and cooperation.

General theoretical frameworks have been built on the experience of successful MNEs from industrialised countries and therefore their applicability to emerging country multinationals has been constantly challenged (Mathews 2006, Aykut and Goldstein 2006) and we also do not expect a straightforward application of the general theoretical framework in case of India. For instance, emerging MNEs possess soft and generic ownership advantages originating from home country and their motivations for undertaking FDI are unconventional. Market seeking FDI is undertaken to support foreign trade such as by the acquisition of distribution networks; strategic- asset seeking FDI aims at acquisition of advanced foreign technology and know-how; and the low cost characteristics of their home economies deters efficiency seeking FDI.

Geographic and cultural distance may also not be important in the context of Indian OFDI as South Asia, traditionally India's home region, is the least economically integrated (Foreign Commonwealth Office, 2007) as well as one of the most politically unstable regions in the world. High political risk in the region is due to various factors such as the lack of political harmony, internal and external conflicts, and religion in politics within the member countries. As a result, many Indian MNEs have made investment in geographically and culturally distant, politically stable and open economies such as the UK and the USA.

Special drivers of Indian outward direct investment

We argue in this paper that Indian firms have access to a set of ownership advantages that originate from source country CSAs. This section briefly examines these CSAs which have enabled Indian MNEs to make foreign acquisitions.

***Institutional Factors*:** Studies in the field of international business (Kogut and Singh, 1988; Peng, 2002; Scott, 2002; Meyer and Nguyen, 2005; Wright et. al., 2005) have explored the impact of institutional factors on FDI decisions. Institutional factors can either act as barriers to foreign investors or as a facilitator for FDI. Firms mould their OFDI strategies according to changing institutional frameworks. Government support, in the form of subsidies, easy and simple norms of raising foreign funds can promote foreign investment by offsetting ownership and locational disadvantages abroad (Aggrawal and Agmon, 1990). However, bureaucratic controls, lengthy administrative procedures, quotas, licenses and approvals for capital outflows can negatively impact the flow of foreign investment. Therefore, the institutional fabric and the degree of structural transformation can influence and determine OFDI by domestic firms (Lall, 1996; Duran and Ubeda, 2001; Buckley, et. al. 2007).

India's outward investment policy was gradually liberalised in the mid-1990s, but it is in the post-2000 period when significant liberalization took place in OFDI policies (see table A-2). In a recent FICCI study quoted in Nayyar (2008), FICCI observed that the liberalisation of the policy regime for outward investment in 2005 which allowed Indian firms to invest in entities abroad up to 200 per cent of their net worth in a year coincided with a sharp rise in cross-border acquisitions. Similarly, further liberalisation in 2007 which raised the overseas investment limit to 400 percent of net worth in a year, also coincided with rising acquisitions both in numbers and in value.

***Domestic Capital Market*:** is a macroeconomic determinant strongly associated with FDI. FDI flows are positively associated with source country stock market as high stock valuations at home make

financing cheaper by reducing the cost of capital (Baker et. al., 2008). Stock market valuations were also found to have significant explanatory power for US investments abroad (Barro, 1990) as MNEs make extensive use of their internal capital market to finance FDI projects (Herzer, 2008). The association between stock market valuation and FDI is a very strong one. As Baker puts it, "the effect of source country valuations is stronger, in statistical terms, than any other determinant of FDI that we study, and to our knowledge may be the strongest effect on FDI yet documented in the literature. This relationship is consistent with the cheap finance story" (Baker et al., 2008, pg. 22).

India's capital market remained buoyant especially during the period 2003 to 2007 with significant inflows of global portfolio investments. These conditions have enabled firms to raise equity from both primary and secondary markets. Interestingly, Indian firms raised most of the capital in India during this period and this also coincided with increasing levels of cross-border acquisitions by Indian MNEs. Thus, it is likely that the boom in the domestic capital might have enabled Indian firms to finance overseas acquisitions.

***Foreign Exchange Rate*:** International trade theory suggests that an appreciation of home currency makes the exports of goods and services more profitable while decreasing the cost of foreign investments. Several studies (Aliber, 1970, Stevens, 1993, Blonigen, 1997) cite the exchange rate as a critical determinant of FDI. The currency area hypothesis by Aliber states "the weaker the currency of a country the less likely it is that foreign firms will invest in that location. The crucial assumption of this theory is the existence of a bias in the capital market: the bias is assumed to arise because an income stream from a country with a weak currency is associated with an exchange rate risk and, therefore, an income stream is capitalised at a higher rate by the market when it is owned by a weak currency firm" (Chakrabarti, 2001, p. 100). Therefore, a relatively cheap home currency can make (overseas) valuations relatively costlier.

Strengthening of the Indian rupee against the US dollar in recent years made valuations of (overseas) target companies attractive. This could be an enabling factor behind recent acquisitions by Indian corporates. The exchange rate of the Indian rupee against the US dollar reached its peak in 2002 when the Indian rupee traded at an annual average rate of 48.6 against a US dollar. The Indian rupee later appreciated by more than 15 per cent against the US dollar by 2007 and the rupee traded at an annual average rate of 41.2 against the US dollar. This appreciation of the Indian rupee also coincided with the rising number of Indian acquisitions overseas.

***Language*:** The Stages model of internationalisation suggests that early investments tend to take place in countries with similar cultural backgrounds (Johanson and Vahlne, 1977, 2009). Language familiarity tends to be an important driver of foreign direct investment (Doh et al., 2009, Akkermans, et al., 2008; Feely and Harzing, 2002) because it can considerably lower transaction costs (Williamson, 1981) and facilitate business exchange (Doh et. al, 2009). A common language subconsciously influences an individual's attitude and values (cultural accommodation) and can help bridge cultural and psychic distance (Bond and Yang, 1982; Doh et. al, 2009).

India is culturally close to western countries, in particular the USA and the UK because of the English language. India has adopted English as a second official language and the use of the English language is prevalent within the Indian business community, thus we anticipate that Indian firms would be more inclined to do business with English speaking countries.

The determinants of foreign acquisitions by Indian multinationals

We now propose various hypotheses derived from the general theory and the special drivers for Indian OFDI. Our first set of hypotheses is based on host country location-specific determinants, while the second set of hypotheses is based on source country-specific ownership advantages. Finally,

further hypotheses are formulated in relation to the geographical and cultural distance between host and source countries.

Host country location specific determinants

Host country location-specific determinants include general explanations including motivations for undertaking FDI and attributes of the host country such as political risk, corporate tax, openness of the host country, and geographical distance from the source country.

***Market seeking FDI*:** Many studies have found a positive relationship between FDI and the market size of the host country (see Chakrabarti, 2001). Market seeking FDI aims to service foreign market leveraging marketing skills and overseas distribution networks. Acquisition of local firms is often regarded as a quicker route relative to greenfield investments especially as Indian firms generally lack powerful and recognisable brand names (Sauvant, 2005). In many cases, Indian MNEs have made foreign acquisitions for market seeking motives, for instance: Tata's acquisition of UK-based Tetley tea in 2000 and USA-based Good Earth tea in 2005; United Spirits acquisition of Glasgow based liquor company Whyte & Mackay Ltd in 2007. We therefore hypothesise the following:

> **Hypothesis 1:** The number and the value of foreign acquisitions are positively correlated with a host economy's market size.

***Resource seeking FDI*:** Resource seeking FDI aims at controlling and accessing the natural resources of a host economy. Internalisation theory asserts the importance of equity-based control in the exploitation of natural resources (Buckley et. al., 2007) made possible by acquisitions. Although this strategic move to acquire natural resources occurs mainly in the manufacturing sector, and India is prominently a service driven economy, there are important instances where Indian MNEs have secured access to inputs to sustain their growth. Examples include acquisition of Russia's Sakhalin

and Sudan's Greater Nile by ONGC; USA's General Chemicals by Tata Chemicals in 2008 and Corus by Tata Steel in 2006. Thus, we hypothesise the following:

> **Hypothesis 2:** The number and the value of foreign acquisitions are positively correlated with host country endowments of natural resources.

***Strategic- asset seeking FDI*:** India is a knowledge-based economy and a number of foreign acquisitions by Indian firms have been directed at the acquisition of knowledge and technology to complement their FSAs. Pradhan (2007) argues that many software companies from India might have moved abroad to acquire knowledge, skill and technology not available at home. There are various examples of acquisitions in knowledge-based industries made to access foreign technology and know-how – for example, the acquisition of the small molecules business of Dowpharma, a Cambridge-based biotechnology company and Betapharm Arzneimittel GmbH of Germany by Dr Reddys Laboratories Ltd. Thus, we hypothesise that:

> **Hypothesis 3:** The number and the value of foreign acquisitions are positively associated with host country endowments of knowledge-based assets.

***Political risk*:** Empirically, FDI has been shown to be sensitive to, and inversely correlated with, political risks in host countries (Harms, 2002). Internalisation theory suggests that countries with high political risks will be served by arm length-servicing modes, such as exporting, licensing, and outsourcing (Buckley and Casson, 1981, 1999; Delios and Henisz, 2003) because FDI involves higher commitment and the existence of sunk costs. However, high risk markets may offer higher returns and thus attract high levels of FDI. The role of high return can be controlled by inclusion of market related variables (Buckley et al., 2007).

> **Hypothesis 4:** The number and the value of foreign acquisitions are negatively associated with high levels of host countries' political risk.

***Corporate tax*:** FDI decisions may be shaped by the nature of taxation provisions in host countries and their impact on the returns of investment projects (Swenson, 1994). Various time-series studies report a positive correlation between higher after-tax returns and the amount of FDI (Desai et. al., 2004). Corporate tax rates play an important role in the location choices of MNEs as, all other things equal, firms prefer to locate activities in low statutory tax rate countries (Grubert and Slemrod, 1998). We therefore hypothesise:

> **Hypothesis 5:** The number and the value of foreign acquisitions are negatively associated with the host country corporate tax rate.

***Openness of host economy*:** Chakrabarti (2001) reports mixed evidence of the significance of trade openness of an economy (ratio of foreign trade to GDP) in determining FDI. Trade barriers mainly discourage trade and influence FDI decisions for instance the FDI's *tariff jumping* hypothesis (Asiedu, 2002) which means in economies characterized by low degrees of trade openness export may be replaced by FDI. In contrast, in economies with high degree of trade openness, FDI may replace exports, if the host country is geographically distant. Nevertheless, geographical distance may still affect the choice of FDI as a foreign market servicing strategy relative to exporting and this can be controlled for by inclusion of geographical distance as a separate variable. Therefore, we hypothesise:

> **Hypothesis 6:** The number and the value of foreign acquisitions are positively associated with the trade openness of the host economy.

Source country-specific ownership advantages

This section builds hypotheses for country specific variables (CSAs) emanating from the source country (India) based on general explanations such as inward FDI flows as well as special drivers such as India's outward FDI policy, foreign exchange rate, capital market, cultural affinity and use of the English language.

***Inward FDI flows*:** The IDP theory[iii] suggests that capital flows in the form of FDI act as catalysts in the economic development and growth of the FDI recipient country and through a series of structural transformations, outward FDI activities by domestic firms start to occur (Dunning, 1981, 1986, 1993b; Dunning and Narula, 1996, Barry et al., 2003). However, in the context of India, OFDI flows have started to increase steeply in recent years, "a surprising result for a poor country" (Ramamurti and Singh, 2008 p.1). Thus, we anticipate that outward FDI flows are not linked with inward FDI:

> **Hypothesis 7:** The number and the value of foreign acquisitions are not associated with India's inward FDI flows.

***Outward investment policy*:** Institutional **c**hanges are fundamental changes that can affect foreign investment trends and patterns. We argue that changes in the outward investment policy of India have allowed Indian MNEs to undertake larger deals and consequently OFDI has been increasing significantly. A major liberalisation in outward investment policy took place in 2003, when the absolute limit on FDI was replaced by a relative limit and companies were allowed to invest 100 percent of their net worth abroad. We therefore hypothesise:

> **Hypothesis 8**: The number and the value of foreign acquisitions are positively associated with the liberalisation of India's overseas investment policies in 2003.

***Foreign exchange rate*:** An appreciation of a home country's currency discourages exports and encourages overseas investment. The exchange rate is a critical determinant of OFDI (Aliber, 1970, Stevens, 1993, Blonigen, 1997). Recent appreciation of the Indian rupee may have impacted on the volume of foreign acquisitions. Therefore, our hypothesis is:

> **Hypothesis 9:** The number and the value of foreign acquisitions are negatively associated with depreciation of USD against INR.

***Domestic capital market*:** A firm's stock market valuation is inversely correlated with its cost of capital (Baker et. al., 2008). Increasing stock prices during the period of 2003 to 2007 also coincided with a similar trend in the foreign acquisitions by Indian companies. The high market valuation of Indian companies stocks in domestic capital market might have enabled Indian MNEs to finance their overseas acquisitions. Therefore, we hypothesise that:

> **Hypothesis 10:** The number and the value of foreign acquisitions are positively associated with the index of domestic stock market value.

***Language proximity*:** Recent studies (Akkermans, et al. 2008, Doh et al., 2009) have found language to be an important determinant of OFDI decisions. Competence in the English language may be another important source of advantage for Indian firms in English speaking countries. Thus, the following hypothesis is created.

> **Hypothesis 11:** The number and the value of foreign acquisitions are positively associated with the use of English in host countries.

Distance between home and source country

This section builds hypotheses covering cultural and geographical distance between the host and source country.

***Cultural affinity*:** Cultural affinity reduces transaction costs and therefore attracts FDI. The Uppsala or Stages model of internationalisation (Johanson and Vahlne, 1977, 2009) suggests that MNEs internationalise gradually, initially to neighbouring countries, where physical and psychic distance are low and is complementary to locational explanations. The smaller these distances are, the lower are transaction costs likely to be. However, Indian OFDI's inclination towards the USA and UK and low levels of economic integration within the home region of South Asia (Foreign Commonwealth Office,

2007) suggest that cultural distance might apply differently in the context of Indian OFDI. Hence we hypothesise:

Hypothesis 12a: The number and the value of foreign acquisitions are not significantly associated with the host country's cultural distance from India.

Hypothesis 12b: The number and the value of foreign acquisitions are not significantly associated with the host country's power distance index from India.

Hypothesis 12c: The number and the value of foreign acquisitions are not significantly associated with the host country's difference in uncertainty avoidance index from India.

Hypothesis 12d: The number and the value of foreign acquisitions are not significantly associated with the difference in host country's individualism index from India.

Hypothesis 12e: The number and the value of foreign acquisitions are not significantly associated with the host country's difference in masculinity index from India.

***Geographical distance*:** Internalisation theory (Buckley and Cassons, 1981) suggests the importance of role that geographical distance between home and host countries has in OFDI decisions. The higher the geographical distance between home and host countries the higher the transaction cost. As a result FDI flows are expected to be negatively correlated with geographical distance between host and source country. However, Indian OFDI through acquisitions tends to be targeted at gographically distant developed countries such as the USA and the UK. Therefore, geographical and cultural distances are likely to apply differently in the context of Indian OFDI. A physical distance variable is also needed to complement the cultural distance variable, to isolate its effect (Buckley et al., 2007). Therefore, we hypothesise:

Hypothesis 13: The number and the value of foreign acquisitions are not significantly associated with the geographic distance between home and host countries.

Method and Data

To test our hypotheses we have constructed two models based on two dependent variables, namely the number of foreign acquisitions abroad by Indian firms and the value of these acquisitions over the period 2000-2007. We match the dependent variable (acquisitions both in numbers and value) by year and by host country and collect independent variables (such as host country's GDP, political risk, patents applications and so on) by year for each host country to create a panel data set. We transformed both dependent and a set of independent variables into natural logarithms and derived a log-log linear model. The log-log function enables the transformation of a non-linear relationship between our dependent and independent variables into a linear one. It measures FDI elasticity with respect to our set of explanatory variables (Crown, 1998). Thus, our models are as follow:

(1) $Ln(MAValue_{it}) = a + b_1 \ln(GNIPC_{it}) + b_2 \ln(RESOURCE_{it}) + b_3 \ln(PATENT_{it}) + b_4 \ln(POL\_RISK_{it}) + b_5 \ln(CTAX_{it}) + c_1 \ln(INWARDFDI_{jt}) + c_2 \ln(POLICY_{t-2}) + c_3 \ln(SENSEX_{jt}) + c_4 \ln(FERATE_{it}) + c_5 \ln(LANUGAGE) + d_1 \ln(GEOG\_DIST_{i-j}) + d_2 \ln(CULTURE\_INDX_{i-j}) + d_3 In(PDI_{i-j}) + d_4 In(MAS_{i-j}) + d_5 In(UAI_{i-j}) + d6(IND_{i-j})$

(2) $Ln(MANo_t) = a + b_1 \ln(GNIPC_{it}) + b_2 \ln(RESOURCE_{it}) + b_3 \ln(PATENT_{it}) + b_4 \ln(POL\_RISK_{it}) + b_5 \ln(CTAX_{it}) + c_1 \ln(INWARDFDI_{jt}) + c_2 \ln(POLICY_{t-2}) + c_3 \ln(SENSEX_{jt}) + c_4 \ln(FERATE_{it}) + c_5 \ln(LANGUAGE) + d_1 \ln(GEOG\_DIST_{i-j}) + d_2 \ln(CULTURE\_INDX_{i-j}) + d_3 In(PDI_{i-j}) + d_4 In(MAS_{i-j}) + d_5 In(UAI_{i-j}) + d6(IND_{i-j})$

The definition and source of each variable in our models are highlighted in Table 1, which shows that our independent variables were sourced from reliable sources. Our model specification is also reliable because we covered both aspects of acquisitions: the number and the value.

In the above regression models, i stand for host country; j stands for source country, t for time and i-j stand for the difference between home and host country. Thus, $MAValue_{it}$ refers to an acquisition in the i^{th} country at time t. Similarly, $RESOURCE_{it}$ refers to natural resources in the i^{th} country at time t, while $SENSEX_{jt}$ refers to domestic stock exchange index in the source country (India) at time t, $GEOG\_DIST_{i-j}$ refers to geographical distance between home and host country and so on.

We use a dummy variable for LANUAGE (equal to 1 for country i if English is official or primary national language or national lingua franca, and 0 otherwise) and POLICY (equal to 1 for the period from 2000 to 2005 and 0 for period from 2006-2008). We utilise a lag of two years for policy variable.

Political risk was measured using a weighted composite index which is made up of 12 different country specific variables such as internal, external conflicts; religion, military in politics; socioeconomic conditions; government stability; corruption, law and order; bureaucracy; and democratic accountability. The index used is comprehensive and covers social, economic, political and financial aspects of a country. The higher the index, the lower is the risk and vice versa.

The modified version of Kogut and Singh's index is used in various studies (e.g., Kale, 1991; Benito and Gripsrud, 1992; Agarwal, 1994; Barkema et al., 1996). The Kogut and Singh (1988) composite index on cultural distance is based on a formula which takes the difference between the index scores of the different countries relative to the USA. To use the index with reference to India we took the difference between various host countries relative to India. Thus, algebraically

$$CD_j = \sum_{I=1}^{4} \{(I_{ij} - I_{id})^2 / V_i\} /4$$

Where, CD_j = cultural distance of i^{th} country from India

I_{ij} = index of the i^{th} cultural dimension and the j^{th} country

I_{id} = index of the i^{th} cultural dimension of the India (d stands for India).

V_i = is the variance of the index of the i^{th} cultural dimension.

The Reserve Bank of India does not compile data on cross border mergers and acquisitions. As a result, we sourced annual data on foreign acquisitions by Indian firms from Thompson One Banker's M&A database. We tested the database's exhaustive coverage by manually checking all reported acquisitions for a sample period of six months and were satisfied with the database coverage. Our

dataset reveals that 866 acquisitions of firms based in 82 countries took place over the period 2000-2007 by Indian firms.

TABLE 1 AROUND HERE

Results and Discussion

The OLS (Ordinary Least Square) multiple regression results for both the models are presented in tables 2 and 3, where table 2 presents the results when acquisitions in number was the dependent variable and table 3 presents the results when acquisitions in value was the dependent variable. To check the collinearity table A1 presents the correlation matrix and the variance inflation factor (VIF) while tolerances are shown in tables 2 and 3. We found no evidence of multicollinearity within the data. Our results appear robust and consistent across both models.

Location specific attributes of the host country

Our results show that host country market size (measured by per capita national income, i.e., GNIPC), endowment of knowledge assets (PATENTS), openness to trade (OPENESS), socio-political conditions (POL_RISK), are all significant and their signs are in accordance with expectations. Thus hypotheses 1, 3, 4 and 6 are supported. In contrast, the host country's natural resource endowment (RESOURCE), and corporate tax rate (CTAX) are insignificant. Thus, hypotheses 2 and 5 are not supported. We will now discuss what these results mean.

We observed from the data that acquisitions by Indian companies are strongly concentrated in mature, well developed countries such as the USA and the UK. This suggests significant market seeking motives (Hypothesis 1). Developed, high income-per-capita countries (GNIPC) provide Indian firms with strong incentives to establish a local presence, primarily because of the size of their markets. Acquisitions provide speedy entry in the foreign markets and obtaining well-established brands, marketing skills and marketing distribution networks overseas (Pradhan and Abraham, 2005). Brand building is one of the major desires of Indian companies when investing abroad (Sauvant, 2005).

Acquisition is also a more sensible way to acquire market share, especially in developed countries where markets are often highly competitive and saturated.

The resource seeking (Hypothesis 2) motive for FDI is not significant while strategic- asset seeking (Hypothesis 3) is significant. This reflects the fact that India is a service driven economy rather than a manufacturing hub like China with its associated natural resource seeking motives (Buckley et al., 2007). Indian companies are assessing foreign technology in order to build their competitive edge in the world economy. However, the current Indian government has realised that manufacturing is necessary for overall growth and we might expect to see resource seeking FDI gaining significance in the future.

Political risk (POL_RISK) (Hypotheses 4) was also significant and had the expected positive sign. The higher the political risk index (i.e., low political risk), the higher is the investment. Our argument is that India has poor track record on various social, economic and political indicators of political risks, and therefore, Indian MNEs are looking for safe and peaceful places to conduct business. Our argument can also be construed to mean that Indian companies are pushed by domestic factors to internationalise and this argument is subject to further tests. Thus, Indian MNEs perceive and behave towards political risk in the manner that industrially advanced countries MNEs do and therefore, OFDI decisions of Indian MNEs are significantly affected by the political risk in host countries.

Our last locational determinant, corporate tax rates in host countries (CTAX) (Hypothesis 5), appears to be insignificant. Arguably, there should be a negative relation between OFDI and corporate taxation in the host country as companies generally wish to avoid tax. However, this effect may only be apparent when multinationals have successfully started operating and are making significant profits. Indian multinationals and their FDI are still new phenomena, their main objective during their initial stages is to attain market share and nurture the business rather than to start minimising the tax liability, which may be their strategy in the longer run.

Openness of the host economy (OPENNESS) (Hypothesis 6) was significant with the expected negative sign. This supports the *tariff jumping* proposition (Asiedu, 2002), it means Indian countries are avoiding anti-dumping duties, in the less open economies, by undertaking FDI.

TABLE 2 AROUND HERE

TABLE 3 AROUND HERE

Country specific advantages of the source country

Having discussed the host country specific factors, we now examine ownership advantages originating from within the source country. In order to evaluate country-specific sources of advantages we considered five sets of determinants: foreign exchange rate (FERATE) of the Indian rupee against the US dollar, the inward flow of foreign direct investment (INWARD_FDI), the liberalisation of India's outward investment policy (POLICY), increases in the domestic capital market (SENSEX) and proficiency in English (LANGUAGE). We find foreign exchange rate (FERATE), domestic stock market (SENSEX), and the language factor (LANGUAGE) are significant with positive signs, as expected. Hypotheses 9, 10 and 11 are supported. Hypothesis 8 is also supported where the lags in policy liberalisation (POLICY) in outward investment policy are also found to be significant but the sign with acquisitions value as dependent variable is negative. Inflows of inward FDI (INFDI) (Hypothesis 7) was not found to be significant. These results are now discussed in more detail.

The IDP theory suggests that inward flows of FDI indirectly boost outward flows of FDI through a series of economic and institutional transformations. In this study we limited our focus to FDI inflows, since the objective of paper was not to test the IDP theory. We found that India's inward FDI flows (Hypothesis 7) are not significant in explaining outward FDI through acquisitions. This may be because India is untypical of developing economies with large FDI outflows in recent years relative to the size of its inflows for a country at the early stages of its development path.

In this study we have argued that the policy changes in 2003 (POLICY) (Hypothesis 8) is likely to have encouraged Indian firms to undertake OFDI. Table 2 shows that acquisition numbers do respond in the predicted fashion (positive and significant) but Table 3 shows that the results are significant (with an incorrect sign) for acquisition value. Further tests (not reported have) found that a three year lag produced a significant sign. Further research (following Buckley et al., 2003) is required to investigate the effect of policy lags on OFDI. In addition, the inevitably start devotion of this study restricts our ability to fully explore the impact of policy liberalisation.

India's main stock exchange, the Bombay Stock Exchange (BSE) index is called *Sensex*. We found that foreign acquisitions had a significant positive relation with the *Sensex* (Hypothesis 9). We also observed from the BSE data that most of the capital was acquired by Indian companies during the period 2003-2007 when the domestic stock market was booming. Thus, it is likely that Indian companies might have used the capital raised during the domestic capital market boom to fund these foreign acquisitions.

Appreciation of Indian rupee, especially during the 2003-2007, resulted in a favourable foreign exchange rate (FERATE) (Hypothesis 10). Since the exchange rate (direct quote) used for this paper was INR per USD, a negative sign supports our hypothesis. The significance of foreign exchange rate suggests that the strengthening of Indian rupee has made valuations of foreign target companies more attractive and this has increased the purchasing power of Indian companies when making acquisitions abroad. Thus, strengthening of the Indian Rupee against the US dollar appears to have encouraged Indian firms to undertake foreign acquisitions away from home because it has made valuations of foreign companies more attractive, when expressed in the home-country currency.

Among the cultural variables under investigation, we find proficiency of Indians in English (LANGUAGE) (Hypothesis 11) acts as a country specific advantage. English is the second official language in India and undoubtedly first in the private sector business community. Proficiency in the

English language acts as an intangible asset for many Indians businesses when operating in countries where English is either the first or second official language. Strong significance with a positive sign for the language factor suggests Indian companies prefer to do business with English speaking partners.

Distance variables

For the distance variable we choose geographic distance (GEOG_DIST), cultural distance (CULTURE_INDEX) and differences in Hofstede's four dimensions of national culture (PDI, UAI, IND, MAS) between the source and host country. This covers hypotheses 12a to 12e and 13, and we find both geographic and cultural distances as expected are largely insignificant.

Geographic distance (Hypothesis 13) affects the transaction costs and therefore is generally an important factor in internalisation. However, as expected, in the case of India this factor was found insignificant. The insignificance of geographic distance is supportive of the bitter rivalries within the South-Asia region especially among India, China and Pakistan that have made this region one of the least integrated (Foreign Commonwealth Office, 2007). Despite the fact that these countries are geographically close, foreign investment does not flow significantly to these countries; rather it goes to more distant western countries.

Finally, among other cultural variables (Hypothesis12a to 12e), Kogut and Singh's (1988) cultural distance index (CULTURE_INDEX) and Hofstede's (1983) power distance index (PDI) were found to be insignificant, while masculinity (MAS) showed mixed results; significant with respect to value of acquisitions and non-significant with respect to numbers. We compute the relative distance with respect to India, which means Indian firms appear able to operate in countries which have a different power distance when compared with India. However, Hofstede's (1983) index on individuality (IND) and uncertainty avoidance (UAI) were significant. In this respect it is argued that Indian

multinationals are able to operate in countries with high levels of individualism, typically western societies. However, in contrast, as argued before, Indian multinationals are still in their infancy in terms of internationalisation and therefore uncertainty avoidance may be their aim, and the significance of political risk indicates something similar. Thus, Indian multinationals seeks to invest in countries which have lower uncertainties and ambiguities.

Conclusion

This paper is a first attempt to model the determinants of Indian OFDI through acquisitions by reference to location or country-specific variables. Using a panel dataset on foreign acquisitions by Indian MNEs in 82 countries over the period 2000-2007 we tested a number of hypotheses. We find that Indian OFDI through cross-border acquisitions has novel, idiosyncratic and conventional dimensions. While we found that Indian acquisitions abroad were primarily motivated by market-seeking purposes and strategic- asset seeking objectives, but we did not find evidence of resource seeking FDI. These results may reflect the economic configuration of the Indian economy, which is largely knowledge and service based and therefore Indian MNES are seeking strategic assets such as knowledge and technological assets rather than natural resources.

Among host country location variables, host countries' with lower political risk and countries with high uncertainty avoidance are preferred which shows the risk aversive nature of Indian multinationals. This may be because Indian multinationals are newly internationalising. The insignificance of host countries corporate tax rates indicates that Indian MNEs are new players trying to establish themselves in world economy, looking for markets and strategic-assets rather than minimise tax which may be a longer term strategy.

Indian firms seem to be driven by country specific factors such as the appreciation of the Indian rupee against the US dollar which had made the valuation of foreign companies cheaper and this was augmented by rising valuations in the home stock market which appears to have helped fund such

acquisitions. English language proficiency has apparently contributed to such investments, since it makes Indian firms more effective in world markets, particularly in English speaking countries. This may explain why the USA and the UK are the two largest host countries for Indian MNEs.

Low integration within the South-Asia region and geographic distance seems to have pushed OFDI from India to developed countries such as UK and USA. This is certainly supported by other factors such as the English language factor, low political risk, and endowment of knowledge-assets as well as large market size.

Institutional changes, especially changes in outward FDI policy in 2003, have boosted outflows of FDI with a lag of two to three years, but OFDI is not primarily driven by rising inflows of FDI; there are different motives for such FDI such as market and strategic-asset seeking goals. However, this should be further tested with the addition of data beyond 2007. Similarly, we anticipate that resource-seeking motives could become significant with the addition of more recent data as the Indian government emphasises the development of the manufacturing sector. Finally, further research adopting a qualitative approach would be useful in assessing the results reported here.

This study suggests the need to examine the relationship between country and firm specific advantages and the methods by which firms can convert CSAs into FSAs from which they can extract returns. There is also a need to explore the impact of lag structure of some of the key explanatory variables, notably policy, on subsequent OFDI. The study is unable to examine post merger success and strategies with regard to the integration of acquired foreign assets into the Indian firm. This is a suitable subject for further work and is of vital importance. The success of Indian OFDI is dependent not only on making the right acquisitions, but also their future management.

Table 1: **Variables and Data Sources**

	Variable (General)	Proxies	Expected Sign	Theoretical Justification	Data Source
Dependent Variables	Value of Foreign Acquisitions by Indian firms **(MAValue)** Number of Foreign Acquisitions by Indian firms **(MANo)**	Dependent variables			Thomson One Banker
Location Variables	Market Size of Host Country **(GNIPC) Hypothesis 1**	GDP and Per Capita GDP	+	Market Seeking	World Bank Development Indicator
	Natural Resource Endowment of Host Country (**RESOURCE**) **Hypothesis 2**	Ratio of Ore and Metal Exports to Merchandise Exports of Host Country	+	Resource Seeking (Leverage)	World Bank Development Indicator
	Endowment of Knowledge Based Asset of Host Country **(PATENT) Hypothesis 3**	Yearly Patent Registration by Residents in Host Country	+	Resource Seeking (Leverage)	World Intellectual Property Organisation
	Political Risk **(POL_RISK) Hypothesis 4**	Host country's political risk rating	-	Transaction Cost	International Country Risk Guide
	Corporate Tax **(CTAX) Hypothesis 5**	Corporate Tax Rates in Host Country	-	Transaction Cost	OECD: Centre for Tax Policy and Administration
	Economy Openness of Host Country **(OPENNESS) Hypothesis 6**	Ratio of Foreign Trade to GDP	+	Transaction Cost	World Bank Development Indicator
Source Country Variables (CSA)	Direct Capital Flow **(INWARDFDI) Hypothesis 7**	Inward FDI in home country	+	IDP	DIPP
	Outward Investment Policy Liberalisation **(POLICY) Hypothesis 8**	Time dummy variable	+	Institutional Factors	Reserve Bank of India
	Domestic Capital Market **(SENSEX) Hypothesis 9**	Bombay Stock Exchange Index	+	Special Variable (Ownership Advantage)	Bombay Stock Exchange
	Exchange Rate **(FERATE) Hypothesis 10**	Host country official annual average exchange rate against dollar	-	Macro Economic Factors	World Bank Development Indicator
	English Speaking Host Country **(LANGUAGE) Hypothesis 11**	Binary Code	+	Uppsala Model	Krysstal.Com
Country Distance Variables	Cultural Distance Index (**CULTURE_INDEX**) **Hypothesis 12a**	Kogut and Singh CD Index	–	Uppsala Model	Kogut and Singh (1988)
	National Cultural (**PDI, UAI, IND, MAS**) **Hypothesis 12b, 12c, 12d, 12e**	Hofstede's National Cultural Dimensions	–	Uppsala Model	Hofstede (2002)
	Geographical Distance of Host country **(GEOG_DIST) Hypothesis 13**	Distance between the capitals of host and home country	–	Transaction Cost	Calculated using www.geobytes.com

Table 2: Results for Acquation Number

Variables	Standardized Coefficients Beta (Significance)							Collinearity Statistics	
								Tolerance	VIF
(Constant)	-22.407	-22.626	-28.099	-29.656	-29.761	-33.210	-33.009		
	(.198)	(.193)	(.000)	(.000)	(.000)	(.000)	(.000)		
LGNIPC	.095	.093	.093	.098	.102	.106	.100	.447	2.237
	(.076)*	(.080)*	(.081)*	(.057)*	(.046)**	(.039)**	(.049)**		
LPOL_RISK	.117	.117	.117	.113	.126	.128	.134	.485	2.061
	(.023)**	(.023)**	(.023)**	(.025)**	(.008)***	(.007)***	(.005)***		
LFERATE	-.125	-.122	-.122	-.123	-.116	-.115	-.114	.682	1.466
	(.004)***	(.004)***	(.004)***	(.004)***	(.005)***	(.005)***	(.006)***		
LSENSEX	.206	.209	.199	.201	.201	.242	.243	.149	6.723
	(.026)**	(.024)**	(.024)**	(.023)**	(.023)**	(.003)***	(.003)***		
LOPENNESS	-.147	-.146	-.145	-.141	-.137	-.137	-.132	.589	1.697
	(.002)***	(.002)***	(.002)***	(.002)***	(.003)***	(.002)***	(.003)***		
LIDV	.158	.156	.156	.154	.157	.162	.154	.836	1.196
	(.000)***	(.000)***	(.000)***	(.000)***	(.000)***	(.000)***	(.000)***		
LMAS	-.054	-.060	-.060	-.061	-.062	-.058	-.070	.681	1.468
	(.215)	(.124)	(.124)	(.116)	(.111)	(.134)	(.062)*		
LUAI	.079	.082	.082	.087	.089	.088	.083	.768	1.303
	(.052)*	(.042)**	(.042)**	(.025)**	(.021)**	(.022)**	(.030)**		
LPATENT	.129	.130	.131	.128	.130	.137	.132	.646	1.548
	(.004)***	(.004)***	(.003)***	(.003)***	(.003)***	(.002)***	(.002)***		
LANGUAGE	.106	.106	.106	.108	.104	.102	.098	.811	1.233
	(.008)***	(.008)***	(.008)***	(.006)***	(.008)***	(.009)***	(.012)***		
POLICY (Dummy)	.203	.201	.188	.187	.192	.148	.148	.151	6.632
	(.028)**	(.029)**	(.027)**	(.028)**	(.024)**	(.050)**	(.050)**		
LCULTURE_INDEX	-.051	-.053	-.053	-.055	-.054	-.053		.832	1.201
	(.195)	(.165)	(.165)	(.148)	(.154)	(.162)			
LCTAX	.045	.044	.042	.040	.047			.682	1.466
	(.294)	(.308)	(.326)	(.346)	(.255)				
LRESORUCES	.045	.045	.044	.039				.522	1.917
	(.360)	(.367)	(.370)	(.413)					
LGEOG_DIST	-.017	-.019	-.018					.690	1.448
	(.695)	(.662)	(.669)						
LINWARDFDI	-.026	-.025						.252	3.961
	(.718)	(.724)							
LPDI	-.015							.600	1.667
	(.750)								
R Square	.303	.303	.303	0.301	.300	.298	.295		
Number	569	569	569	569	569	569	569		
F Value	13.756	14.634	15.626	16.753	18.001	19.383	20.931		

** Significant at 1 %; ** significant at 5%;*significant at 1%

Table 3: Results for Acquation Value

Variables	Standardized Coefficients Beta (Significance)								Collinearity Statistics	
									Tolerance	VIF
(Constant)	-74.77	-74.76	-74.61	-74.08	-75.97	-71.56	-69.29	-70.60		
	(.000)	(.000)	(.000)	(.000)	(.000)	(.000)	(.000)	(.000)		
LSENSEX	.331	.331	.331	.332	.333	.335	.290	.303	.438	2.281
	(.000)***	(.000)***	(.000)***	(.000)***	(.000)***	(.000)***	(.000)***	(.000)***		
LIDV	.162	.162	.158	.153	.156	.164	.163	.167	.485	2.062
	(.000)***	(.000)***	(.000)***	(.000)***	(.000)***	(.000)***	(.000)***	(.000)***		
LFERATE	-.141	-.141	-.135	-.134	-.126	-.121	-.114	-.107	.674	1.484
	(.001)***	(.001)***	(.001)***	(.002)***	(.002)***	(.003)***	(.005)***	(.009)***		
LOPENNESS	-.141	-.141	-.140	-.137	-.129	-.138	-.119	-.097	.235	4.255
	(.003)***	(.003)***	(.004)***	(.004)***	(.006)***	(.003)***	(.008)***	(.022)**		
LANGUAGE	.116	.116	.115	.111	.107	.100	.097	.092	.552	1.811
	(.004)***	(.003)***	(.004)***	(.005)***	(.006)***	(.010)***	(.012)***	(.017)***		
LPATENT	.128	.128	.130	.127	.130	.141	.158	.172	.836	1.196
	(.005)***	(.005)***	(.004)***	(.005)***	(.004)***	(.001)***	(.000)***	(.000)***		
LUAI	.079	.079	.083	.078	.084	.071	.069	.071	.679	1.473
	(.053)*	(.052)*	(.039)**	(.050)**	(.034)**	(.064)*	(.069)*	(.063)*		
LMAS	-.080	-.080	-.090	-.099	-.100	-.095	-.097	-.105	.768	1.303
	(.064)*	(.064)*	(.019)*	(.009)***	(.008)***	(.012)***	(.010)***	(.005)***		
LPOL_RISK	.087	.087	.087	.093	.106	.108	.114	.148	.616	1.623
	(.089)*	(.089)*	(.088)*	(.066)*	(.030)**	(.101)	(.084)*	(.000)*		
LINWARD FDI	.106	.106	.106	.106	.108	.108	.114	.116	.809	1.235
	(.108)	(.108)	(.107)	(.106)	(.099)*	(.101)	(.084)	(.077)		
LGNIPC	.097	.097	.094	.089	.098	.084	.072		.480	2.083
	(.071)*	(.070)*	(.078)*	(.093)*	(.063)*	(.101)	(.158)			
POLICY (Dummy)	-.085	-.085	-.084	-.084	-.080	-.079			.832	1.201
	(.097)*	(.097)*	(.101)	(.102)	(.117)	(.120)				
LGEOG_DIST	.050	.051	.047	.043	.054				.878	1.139
	(.239)	(.235)	(.261)	(.310)	(.183)					
LRESOURCES	.050	.051	.049	.049					.521	1.921
	(.307)	(.297)	(.313)	(.313)						
LCULTURE_INDEX	-.033	-.033	-.037						.692	1.446
	(.397)	(.396)	(.330)							
LPDI	-.025	-.025							.293	3.418
	(.589)	(.591)								
LCTAX	.002								.602	1.662
	(.955)									
R Square	.303	.303	.303	0.301	.300	.298	.295	.292		
Number	569	569	569	569	569	569	569	569		
F Value	14.092	15.000	16.001	17.078	18.312	19.663	21.176	23.053		

*** Significant at 1 %; ** significant at 5%;*significant at 1%

Appendix

Table A1 : Correlation Matrix

	LGNIPC	LReso-urces	LPol Risk	LCTax	LForex	LInFDI	LSensex	LGeog Distance	Lopen ness	LCulture Index	LPDI	LIDV	LMAS	LUAI	LPatent	Language	Policy Lib
LMANo	.167	.135	.146	.074	-.115	.338	.389	.028	-.174	.003	.010	.227	-.096	.155	.092	.037	.373
LMAVaue	.145	.129	.124	.074	-.130	.359	.387	.076	-.183	.022	.006	.234	-.115	.147	.099	.047	.218
LGNIPC	1.000	.500	.614	.142	.270	.036	.046	-.044	.449	-.015	-.012	.103	-.132	.126	.275	-.150	.038
LResource	.500	1.000	.573	.243	.323	.046	.047	.268	.319	-.005	.048	.140	-.029	.145	.192	-.186	.040
LPolrisk	.614	.573	1.000	.116	.330	.001	.001	.191	.348	-.091	-.018	.075	-.063	.106	.198	-.178	.000
LCTax	.142	.243	.116	1.000	.002	-.001	.032	.189	.017	.072	.191	.142	.098	.026	.156	-.062	-.178
LForex	.270	.323	.330	.002	1.000	-.059	-.072	.058	.283	-.067	-.147	-.021	.014	-.077	-.106	.142	-.046
LInFDI	.036	.046	.001	-.001	-.059	1.000	.839	.002	-.317	.000	.001	.000	-.001	-.001	-.282	-.002	.827
LSensex	.046	.047	.001	.032	-.072	.839	1.000	.002	-.336	.000	.000	.000	-.001	-.001	-.316	-.001	.880
LGeogDis	-.044	.268	.191	.189	.058	.002	.002	1.000	-.102	.137	.280	.160	.189	-.167	.150	-.114	.001
Lopenness	.449	.319	.348	.017	.283	-.317	-.336	-.102	1.000	-.099	-.089	-.057	-.056	-.019	.239	-.048	-.270
LCDIndex	-.015	-.005	-.091	.072	-.067	.000	.000	.137	-.099	1.000	.310	.188	.218	.081	.139	.041	.000
LPDI	-.012	.048	-.018	.191	-.147	.001	.000	.280	-.089	.310	1.000	.235	.485	-.174	.099	-.044	.000
LIDV	.103	.140	.075	.142	-.021	.000	.000	.160	-.057	.188	.235	1.000	.032	.132	.228	.039	.000
LMAS	-.132	-.029	-.063	.098	.014	-.001	-.001	.189	-.056	.218	.485	.032	1.000	-.141	.068	-.122	-.001
LUAI	.126	.145	.106	.026	-.077	-.001	-.001	-.167	-.019	.081	-.174	.132	-.141	1.000	.192	-.211	-.001
LPatent	.275	.192	.198	.156	-.106	-.282	-.316	.150	.239	.139	.099	.228	.068	.192	1.000	-.067	-.251
Language	-.150	-.186	-.178	-.062	.142	-.002	-.001	-.114	-.048	.041	-.044	.039	-.122	-.211	-.067	1.000	-.001
PolicyLib	.038	.040	.000	-.178	-.046	.827	.880	.001	-.270	.000	.000	.000	-.001	-.001	-.251	-.001	1.000

Table A2 : India's Overseas Investment: Major Liberalisation Measures

December 1969: The Government of India issued first formal guidelines for overseas direct investment. Under this, Indian parties were permitted minority participation in turnkey projects involving no cash remittances.

April 1978: An Inter-Ministerial Committee in the Ministry of Commerce was set up to clear proposals for overseas investments. There was a requirement for repatriation of 50 per cent dividend from declared profits.

1992: An Automatic Route for overseas investments was introduced and cash remittances were allowed for the first time. The total value was restricted to US $ 2 million with a cash component not exceeding US $ 0.5 million in a block of 3 years.

1995: The work relating to overseas investment was transferred from Ministry of Commerce to RBI to provide a single window. In terms of the policy, a fast track route was introduced where limits were raised from US $ 2 million to US $ 4 million and linked to average export earnings of the preceding three years. Cash remittance continued to be restricted to US $ 0.5 million. Beyond US $ 4 million, proposals were considered under Approval Route at the Special Committee level.

March 1997: Exchange earners other than exporters were also brought under the fast track route. Indian promoters were allowed to set up second and subsequent generation companies, provided the first generation company was set up under the fast track route.

2000: The introduction of FEMA brought about significant policy liberalisation. The limit for investment up to US $ 50 million, which was earlier available in a block of three years, made available annually without any profitability condition. Companies were allowed to invest 100 per cent of the proceeds of their ADR/GDR issues for acquisitions of foreign companies and direct investments in JVs and WOSs.

March 2002: Automatic route was further liberalised wherein Indian parties investing in JVs/WOSs outside India were permitted to invest an amount not exceeding US $ 100 million as against the earlier limit of US $ 50 million in a financial year. Also the investments under the automatic route could be funded by withdrawal of foreign exchange from an authorised dealer (AD) not exceeding 50 per cent of the net worth of the Indian party.

March 2003: Automatic route was significantly liberalised to enable Indian parties to fund to the extent of 100 per cent of their net worth.

February 2004: With a view to enabling Indian corporates to become global players by facilitating their overseas direct investment, permitted end-use for external commercial borrowing (ECB) was enlarged to include overseas direct investment in JVs/WOSs. This would facilitate corporates to undertake fresh investment or expansion of existing JV/WOS including mergers and acquisitions abroad by harnessing resources at globally competitive rates.

May 2005: With a view to promoting Indian investment abroad and to enable Indian companies to reap the benefits of globalisation, the ceiling of investment by Indian entities was revised from 100 per cent of net worth to 200 per cent of the net worth of the investing company under the automatic route for overseas investment.

June 2007: The limit of 200 per cent of the net worth of the Indian party was enhanced to 300 per cent of the net worth under automatic route (200 per cent in case of registered partnership firms).

September 2007: The limit of 300 per cent of the net worth of the Indian party was further enhanced to 400 per cent of the net worth of the Indian party.

June 2008: Indian companies have been allowed to invest in excess of 400 per cent of their net worth as on the date of the last audited balance sheet in the energy and natural resources sectors, such as oil, gas, coal and mineral ores. The investment in excess of 400 per cent of the net worth shall be made only with the prior approval of the Reserve Bank.

Source: Authors compilation from Reserve Bank of India bulletins and Gopinath S. (2007)

References

Agarwal, R. and Agmon, T. (1990). The international success of developing country firms: role of government-directed comparative advantage, *Management International Review*, 30/2, 163-180.

Agarwal, S. (1994). Socio-cultural distance and the choice of joint ventures: a contingency perspective, *Journal of International Marketing*, 2/2, 63-80.

Akkermans, D.; Harzing, A.W.K.; Witteloostuijn, A. van (2008) Cultural Imprinting and Language Priming. Competitive versus Cooperative Behavior in a Prisoner's Dilemma Game, conference proceedings of the 35th Annual Conference of the UK Chapter of the AIB, Portsmouth, 28-29 March.

Akyut, D. and Goldstein A. (2006). Developing country multinationals: South-south investment comes of age, *OECD Development Centre*, WP 257, 1-42.

Aliber, R. Z. (1970). A theory of direct foreign investment". In: C. Kindleberger (eds.*), The International Corporation*: *A Symposium,* Cambridge: MIT Press: 17–34.

Asiedu, E. (2002). On determinants of foreign direct investments to developing countries: Is Africa different? World Development, 30(11), p. 107-119.

Baker, M. C., Fritz F. and Wurgler J. (2008). Multinationals as arbitrageurs: The effect of stock market valuations on FDI, *The Review of Financial Services*, RFS advance access, March 2008.

Balasubramanyam, V.N. and Forsans N. (2009) Internationalisation Drivers of Indian Multinational Firms, *Asian Business & Management*, forthcoming

Barkema, H., Bell, J. and Pennings, J. (1996). Foreign entry, cultural barriers, and learning, *Strategic Management Journal*, 17, 151-166.

Barro, R. J. (1990). The Stock Market and Investment, *The Review of Financial Studies*, 3/1, pp. 115-131.

Barry, F., Gorg, H. and McDowell, A. (2003). Outward FDI and the investment development path of a late-industrializing economy: Evidence from Ireland, *Regional Studies*, 37/4, 341- 349.

Benito, G. and Gripsrud, G. (1992). The expansion of foreign direct investment: discrete rational location choices or a cultural learning process?, *Journal of International Business Studies*, 23/3, 461-476.

Blonigen, B. A. (1997). Firm-specific assets and the link between exchange rates and foreign direct investment, *American Economic Review*, 87/3, 447–465.

Bond, M. H. and Yang, K. –S. (1982), Ethinic Affirmation versus Cross cultural accommodation: The variable impact of questionnaire language on Chinese bilinguals from Hong Kong, Jounral of Cross-Cultural Psychology, 13: 169-185.

Bond, Michael H. (1988). Finding universal dimensions of individual variation in multicultural studies of values: The rokeach and Chinese value surveys, *Journal of Personality and Social Psychology*, 55/6, 1009-1015.

Bongalia, F., Goldstein A. and Mathews J. (2006). Accelerated internationalisation by emerging multinationals: The case of white goods sector, *Munich Personal RePEc Archive*, 1485, 1-37.

Buckley, P. J., and Casson, M., (1981). The optimal timing of a foreign direct investment, *Economic Journal*, 91/361, 75–87.

Buckley, P. J., and Casson, M., (1999). A theory of international operations. In P. J. Buckley and P. N. Ghauri (eds.) *The internationalization process of the firm: a reader*, 2nd edn., London: Thomson, 55–60.

Buckley, P. J., and Hashai N. (2008). Formalizing internationalisation in the eclectic paradigm, *Journal of International Business Studies*, 40/1, 1-13.

Buckley, P. J., Casson, M., (1976). *The future of multinational enterprise*, London: McMillan.

Buckley, P. J., Casson, M., (1985). *The economic theory of the multinational enterprise*, London: McMillan.

Buckley, P. J., Casson, M., (2009). The internalisation theory of the multinational enterprise: A review of the progress of a research agenda after 30 years, *Journal of International Business Studies*, 40, 1563-1580.

Buckley, P. J., Jeremy, C. L., Cross, A. R., Liu, X., Voss, H., Zheng, P., (2007). The determinants of Chinese Outward Foreign Direct Investment, *Journal of International Business Studies*, 38, 499-518.

Chakrabarti, A., (2001). The determinants of foreign direct investment: sensitivity analyses of cross-country regressions, *Kyklos*, 54, 89-114.

Delios, A. and Henisz, W.J. (2003). Policy uncertainty and the sequence of entry by Japanese firms, 1980-1998, *Journal of International Business Studies*, 34/3, 227-41.

Desai M. A., Fritz F., and Hines, J. R. (2004). FDI in a world of multiple taxes, *Journal of Public Economics*, 88, 2727-2744.

Doh, Jonathan P, Bunyaratavej, K. and Hahn, E. D. (2009), Separable but not equal: The location determinants of discrete services offshoring activities, *Journal of International Business Studies*, 40, 926–943.

Dunning, J. H. (1998). Location and the multinational enterprise: A neglected factor? "Journal of International Business Studies," 29(1): 461 – 491.

Dunning, J. H., (1977). Trade, location of economic activity and MNE: A search for an eclectic approach. In B. Ohlin, P. O. Hesselborn, P. J. Wijkmann, (Eds.), *The International Allocation of Economic Activity*, London: McMillan.

Dunning, J. H., (1981). *International production and the multinational enterprise*, London: Allen and Unwin.

Dunning, J. H., (1986). The Investment Development Cycle Revisited, *Weltwirtschaftliches Archiv*, 122: 667–77.

Dunning, J. H., (1993). *Multinational enterprise and the global economy*, Reading: Addison Wesley.

Dunning, J. H., and Narual R., (1996). The Investment Development Path Revisited: Some Emerging Issues. In J.H. Dunning and R. Narula (eds.) *Foreign Direct Investment and Governments: Catalysts for Economic Restructuring*, London and New York: Routledge, 1-41.

Duran, J. J. and Ubeda F. (2001). The investment development path: A new empirical approach and some theoretical issues, *Transnational Corporation*, 10/2, Geneva: UNCTAD.

Feely, A. J., and Harzing, A. W. K. (2002). Forgotten and neglected – language: The orphan of international business research. Paper accepted for presentation at the 62nd annual meeting of the Academy of Management, Denver, August 9th–14th.

Foreign Commonwealth Office (2007). Fourth report of the foreign affairs committee session 2006-07: South Asia response of the secretary of state for Foreign and Commonwealth Affairs, UK.

Grubert H., & Slemrod J., (1998). The effect of taxes on investment and income shifting to Puerto Rico, *The Review of Economics and Statistics*, MIT Press, 80/3, 365-373.

Harms P. (2002). Do civil and political repression really boost foreign direct investments?, *Economic Inquiry*, 40, 651-663.

Herzer, D., (2008). The long-run relationship between outward FDI and domestic output: Evidence from panel data, *Economic Letters*, 100,146-149.

Hofstede, G., (2003). *Culture's consequences: comparing values, behaviours, institutions, and organizations across nations*, London: Sage Publications.

Hofstede, G., (1980). *Culture's consequences: International differences in work-related values*. California: Sage Publications.

Hofstede, G., (1983). National cultures in four dimensions: a research-based theory of cultural differences among nations. *International Studies of Management and Organization*, XIII/1-2, 46-74.

Hofstede, G., (1991). *Cultures and organizations: software of the mind*. Berkshire: McGraw- Hill.

Johanson, J., Vahlne, J. E., (1977), 'The internationalisation process of the firm — a model of knowledge development and increasing foreign market commitments', *Journal of International Business Studies*, 8(1), 23-32.

Johanson, J., Vahlne, J. E., (2009), 'The Uppsala internationalization process model revisited: From liability of foreignness to liability of outsidership, *Journal of International Business Studies*, 40, 1411-1431

Kale, S. H. (1991). Culture-specific marketing communications: an analytical approach, *International Marketing Review*, 8/2, 18-30.

Kalfadellis, P., Gray, J., (2002), Are proxies valued measures of internationalization?, retrieved on November, 19th, 2008, from http://www.aueb.gr/deos/EIBA2002.files/Index.htm

Kogut, B. and Singh, H. (1988). The effect of national culture on the choice of entry mode, *Journal of International Business Studies*, 19/3, 411-432.

Kojima, K. (1973). "A Macroeconomic Approach to Foreign Direct Investment," Hitotsubashi Journal of Economics, 14: 11-21.

Kojima, K. (1975), "International Trade and Foreign Driect Investment: Substitute or Complements," Hitotsubashi Journal of Economics, 16: 1-12.

Kojima, K. (1978), "Direct Foreign Investment: A Japanese Model of Multinational Business Operations," London: Croom Helm.

Kumar, N., (2006), Emerging multinationals: Trends, patterns and determinants of outward investment by Indian enterprises" *RIS Discussion Papers*, 117, 1-54.

Lall, S., (1983). Multinationals from India. In Lall (eds.) *The New Multinationals: The Spread of Third World Enterprises*, New York: John Wiley and sons.

Lall, S., (1996). The investment development path: some conclusions. In J.H. Dunning and R. Narula (eds.) Foreign Direct Investment and Governments: Catalysts for Economic Restructuring, London and New York: Routledge, 322-335.

Mathews, J.A. (2006), Dragon multinationals: New players in 21st century globalisation, *Asia Pacific Journal of Management*, 23, 5-27.

Meyer, K.E. and Nguyen, H.V. (2005). Foreign investment strategies and sub-national institutions in emerging markets: evidence from Vietnam, *Journal of Management Studies*, 42/1, 62-93.

Nayyar, D., (2008). The internationalisation of firms from India: Investment, mergers and acquisitions, Oxford Development Studies, 36/1, 111- 131.

Peng, M.W., (2002), Towards an institutional-based view of business strategy, *Asia Pacific Journal of management*, 19, 251-267.

Pradhan, J. P. and Abraham, V. (2005). Overseas mergers and acquisitions by Indian enterprises: Patterns and motivations, *Indian Journal of Economics*, LXXXV, 365-386.

Pradhan, J.P., (2007). Trends and patterns of overseas acquisitions by Indian multinationals, ISID, WP 2007/10, 1 -36.

Ramamurti R. and J. V. Singh (2008). Indian multinationals: Generic internationalisation strategies. In Ramamurti R. and J. V. Singh (eds.), *Emerging Multinationals from Emerging Markets*, Cambridge: Cambridge U. Press.

Rugman, A. M., (1981). *Inside the multinationals-the economics of international markets*, London and New York: Columbia University Press,

Rugman, A. M., (1985), Internationalization is still a theory of foreign direct investment, *Weltwirtschaftsliches*, Archiv 121, 570–575.

Rugman, A. M., (1996). *The theory of multinational enterprise: The selected scientific paper of Alan M. Rugan,* Cheltenam: Edward Elgar Publishing.

Rugman, A.M. and Verbeke, A. (1992). A note on the transnational solution and the transaction cost theory of multinational strategic management. *Journal of International Business Studies*, 23(4): 761-772.

Sauvant K. P., (2005). New sources of FDI: The BRICS- outward FDI from Brazil, Russia, India and China, *Journal of World Investment and Trade*, 6/5, 639-709.

Scott, W. R. (2002), The Changing world of Chinese Enterprises: an Institutional Perspective. In A. S. tui and C. M. Lau, (eds.) *Management of Enterprise in the people's Republic of China*, Boston: Kulwer Academic Press, 59-78.

Sondergaard, M. (1994). Hofstede's consequences: a study of reviews, citations and replications, *Organization Studies*, 15/3, 447-456.

Stevens, G.V.G., (1993). Exchange rates and foreign direct investment: a note, International Finance Discussion Papers, April, No. 444, Board of Governors of the Federal Reserve System, Washington, DC.

Swenson Deborah L. (1994). The impact of US tax reform on FDI in the US, *Journal of Public Economics*, 54, 243 -266

UNCTAD (2004), India's Outward FDI: a giant awakening?, UNCTAD, New York and Geneva, *UNCTAD/DITE/IIAB/2004/1*, 1- 11

Williamson, Oliver E. (1981). The Economics of organisation : The transaction cost approach', *The American journal of Sociology*, 87/3, 548-577.

Wright, M., Filatotchev I., Hoskisson, R.E. and Peng, M.W. (2005). Strategy research in emerging economies: challenging the conventional wisdom, *Journal of Management Studies*, 42/1, 1-33.

[i] Figure is based on data obtained from the TOB financials. Calculations of figures are not within the scope of this paper and therefore are not part of the paper. However, information is available on personal request to authors.

[ii] Same as i.

[iii] The aim of this paper is limited to explore ability of inward FDI flows in promoting outward FDI flows only. We understand the relation between inward and outward FDI is not straight forward but the aim of this paper is not to look for the various transformations in domestic economy due to inward FDI.