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Indian FDI Falls in Global Economic Crisis: Indian Multinationals Tread Cautiously

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Abstract: Just over a year ago, India's outward foreign direct investment (OFDI) seemed to be on a path of rapid and sustained growth. Its average annual growth of 98% between 2004 and 2007 was unprecedented, far ahead of that of other emerging markets like China (74%), Malaysia (70%), Russia (53%), and the Republic of Korea (51%), albeit from a much lower base. However, much of the recent growth in India's OFDI has been fuelled by large-scale overseas acquisitions, and it faltered when the global financial crisis that started in late 2007 made financing acquisitions harder.

Key words: outward foreign direct investment, BRIC, financial crisis, India

Much of the recent growth in India had been fuelled by large-scale overseas acquisitions, however, and it faltered when the global financial crisis that started in late 2007 made financing acquisitions harder. How will internationalizing Indian firms deal with the global crisis? Will they benefit from the global meltdown − for example, from cheaper asset prices − or become cautious and retreat?

1. Slowdown in 2008, with dim prospects for 2009

The global economic crisis has made Indian firms wary of further expansion abroad. Consequently, actual Indian FDI outflows, which rose to a historic level of nearly USD 18 billion in 2007, fell by 6% in 2008 to under USD 17 billion (annex table 1).[1] This is the first absolute decline in OFDI since 1999. The fall in Indian OFDI is in line with the worldwide decline of 15% in 2008,[2] although it contrasts with China's doubling of its OFDI in 2008.[3] The contraction in Indian OFDI is continuing in 2009, falling to USD 4.7 billion in the first quarter of the current year, a 14% decline over the same quarter last year. The trend in Indian overseas acquisitions in January–June 2009, as compared to the corresponding period in 2008, confirms the decline. Between these two periods, the value of such acquisitions fell by 65%, from USD 8

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[1] The Reserve Bank of India (RBI), from which these figures are taken, tends to underestimate FDI in general, as it does not count re-invested earnings.

[2] UNCTAD (2009), "Global crisis now having strong, wide impact on foreign direct investment, study shows", Press Release, UNCTAD/PRESS/PR/2009/020, May 20.

[3] Kenneth Davies (2009), "While global FDI falls, China's outward FDI doubles", Columbia FDI Perspectives, No.5, May 26, at www.vcc.columbia.edu

billion to under USD 3 billion, and their number fell from 140 to 28 (annex table 2).

This 2008 and early 2009 plunge in Indian OFDI has been asymmetrical across sectors and host regions (annex tables 3, 4 and 5). Indian OFDI in the primary and tertiary sectors has been more resilient in the crisis than OFDI in manufacturing. Between 2007 and 2008, acquisition-led[4] Indian OFDI grew in the primary sector (10%) and in services (19%), while it fell steeply in manufacturing (-79%). The share of manufacturing in Indian OFDI flows thus fell, unsurprisingly, from 84% in 2007 to 49% in 2008. The share of the primary and services sectors in Indian brownfield (i.e., made through mergers and acquisitions) OFDI, on the other hand, grew to 20% and 31%, respectively. In the first half of 2009, the negative impact of the global slowdown spread to the services sector as well. Only the primary sector remained robust, led by ongoing increases in OFDI in the oil segment and the revival of OFDI in mining.

The current decline in Indian investment is widespread among recipients. Among host regions, the fall in Indian brownfield investment was steepest in the developing world (-79%) in 2008, with Asia, which had accounted for 8% of the investment in 2007, falling by 85% in 2008 (annex table 4). Africa did much better, by receiving 69% more brownfield investment in 2008, but this from a very low base of USD 111 million. Acquisitions in the developed world in 2007 had been led by Europe and fell by nearly 54% in 2008. In North America, they fell by 75%.

In the first half of 2009, Indian FDI flows into Africa were sharply higher than the first half of 2008, because of the region's oil and gas resources, while they fell in all other regions. Looking at countries, the two countries accounting for most of the value of Indian acquisitions in both 2007 and 2008 differed sharply in 2009. Indian brown field investment in the United States during the first half of 2009 actually grew by 6% over the first half of 2008, while it fell by 99% in the United Kingdom.

Undertaken mostly by private enterprises, except for a few public-sector firms in the energy sector,[5] Indian OFDI has been driven by several factors, including global growth, business opportunities and increased competition. The effect of market conditions turning adverse in 2008 can be seen in the actions of such Indian companies such as Sakthi Sugars, Reliance Industries, Vardhman Polytex, and Suzlon Energy, which are reportedly wrapping up (or disinvesting from) some of their overseas affiliates because

[4] Much of the discussion in this Perspective draws on data on M&As compiled by the author. As the funds used for cross-border acquisitions need not come just from the home country, the sectoral and geographic distribution of such acquisitions may be different from the distribution of direct investment from India. The reason for using the M&A data in this context is that data on the distribution of OFDI proper is not available.

[5] For a list of large Indian outward investors, see "The growth story of Indian multinationals", The Indian School of Business (ISB) and the Vale Columbia Center on Sustainable International Investment (VCC), 2009, at www.vcc.columbia.edu.

of the current economic meltdown (annex table 6).

2. What led to the downturn?

Several factors account for the decline in Indian OFDI. The global and domestic slowdown in growth was one of these. The advanced economies are predicted to see a sharp fall in their aggregate real GDP growth rate from 2.7% in 2007 to 0.8% in 2008 and -3.8% in 2009, signifying further reduction in overseas demand.[6] Real GDP growth within India fell from above 9% in October–December 2007 to just 5% in October–December 2008. This has led to an erosion of business confidence, reduced consumption and slowing investment, choking off both the domestic and overseas expansion of Indian firms.

The credit crunch in both Indian and overseas market was another factor. Although the Indian banking sector did not suffer quite as much from its exposure to distressed global financial instruments and institutions as banks in some major economies, suffer it did and therefore adopted a cautious lending policy in 2008.[7]7 This in turn led to several domestic and overseas projects being postponed.

In addition, the global financial crisis had a significantly negative impact on other financial sub-sectors like the Indian equity, money and foreign-exchange markets. India's benchmark equity index, the Sensex, had fallen sharply by December 2008, by 48% from its highest-ever level reached in December 2007. All this has restricted Indian firms' access to cheap sources of finance and reduced their profitability. Many Indian companies that had acquired overseas units in the recent past, such as Suzlon Energy, Tata Motors and Hindlaco, had to suspend their rights issues and faced difficulties in raising resources.

The sudden depreciation of the Indian rupee against the US dollar in 2008 also led to heavy losses for many export-oriented Indian companies that had acquired long-term forex derivatives.[8] Several Indian companies, which had borrowed heavily abroad to finance their global acquisitions and Greenfield projects during the period of rapid appreciation of the rupee against the dollar, encountered difficulties in meeting mounting overseas debt obligations after its sudden depreciation in late 2008.[9] The depreciating domestic currency, combined with the collapsing stock prices of Indian companies, reduced these companies' ability to engage in M&As.

[6] International Monetary Fund (2009), "World economic outlook update", July 8, 2009, http://www.imf.org/external/pubs/ft/weo/2009/update/02/index.htm.

[7] Hindu Business Line (2007), "Banks' loss due to sub-prime crisis put at $2 b", Saturday, October 6.

[8] Business Standard (2009), "46 companies suffer forex losses of Rs 1,365cr", May 8.

[9] Pradhan, J.P. (2009) "The global economic crisis: impact on Indian outward investment", MPRA Paper No. 1657, Munich University Library, Germany.

Continued falls in export earnings, especially during October–December 2008, further aggravated the condition of export-dependent Indian firms in a large number of sectors, including software, gems and jewellery, leather, textiles, auto parts, pharmaceuticals, and food processing. Since exporters are leading outward investors, lower export earnings had a significant impact on Indian OFDI in 2008. The sudden collapse of commodity prices like crude oil, natural gas and metals also moderated the outward expansion of natural-resource-seeking Indian firms. Finally, anecdotal reports suggest that Indian firms with overseas affiliates − Bharat Forge, Havells India, Hindalco, Punj Lloyd, Tata Communications − have suffered severe consolidated losses in recent quarters on account of their overseas operations.[10]

3. Future prospects

Recovery in Indian OFDI will depend on the revival of global and domestic growth, improvements in corporate profitability, and the easing of financing from banks and the equity market. The first quarter of 2009 registered stronger GDP growth in India than expected, even though global growth went down. If domestic growth turns out not to be sustainable, however, OFDI may not recover.

Recently announced overseas deals, such as the proposed merger of Bharti Airtel and South Africa's MTN for USD 23 billion and Sterlite Industries' USD 1.7 billion bid for US-based copper-mining firm Asarco, suggest that 2009 might see some positive surprises. Moreover, not every Indian company has financing problems. There are some cash-rich Indian firms, including SMEs, which have not undertaken FDI in the past but may be interested in doing so in the future. These firms can be expected to explore acquisitions, given the cheap valuations of foreign assets.

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Annex

Table 1. Actual Indian FDI outflows, 2008 and early 2009a

Year	Quarter	FDI Equity Loan (US$)		Total	% change over previous year
2008	January – March	38,911,422		5,403	20.6
	April – June	1,346,451		1,797	-65.4
	July – September	2,640,494		3,134	5.4
	October – December	42,541,314		5,569	-2.0
	All Quarters (January – December)	12,926	3,778	16,704	-6.3
2009	January – March	4,159	488	4,647	-14.0

Sources: (i) RBI Bulletin (2009), "Indian investment abroad in joint ventures and wholly owned subsidiaries: 2008-09 (April-March)", July 10; (ii) RBI Bulletin (2009), "Indian investment abroad in joint ventures and wholly owned subsidiaries: 2008-09 (April-December)", April 17; (iii) RBI Bulletin (2009), "Indian investment abroad in joint ventures and wholly owned subsidiaries: 2008-09 (April-September)", January 14; (iv) RBI Bulletin (2008), "Indian investment abroad in joint ventures and wholly owned subsidiaries: 2008-09 (April-June)", October 13; and (v) RBI Bulletin (2008), "Indian investment abroad in joint ventures and wholly owned subsidiaries: 2007-08 (April-March)", July 14. a. The equity data do not include equity of individuals and banks. Quarterly figures may not add up to annual totals due to revision in data.

Table 2. Overseas acquisitions by Indian firms, January–June 2009

Month	Value (US $million)		% change of previous year	Number of Deals		% change of previous year
	2008	2009		2008	2009	
January	1304	29	-97.8	28	6	-78.6
February	602	132	-78.1	19	5	-73.7
March	3,019	2,316	-23.3	23	10	-56.5
April	746	40	-94.6	28	1	-96.4
May	569	54	-90.5	19	4	-78.9
June	1,731	243	-86.0	23	2	-91.3
All Above Months	7,971	2,814	- 64.7	140	28	-80.0

Sources: Based on a dataset constructed from reports from newspapers, magazines and financial consulting firms like Hindu Business Line, Economic Times, Financial Express, Business World, Grant Thornton India, and ISI Emerging Markets.

Table 3. Sectoral composition of Indian overseas acquisitions, 2008 and early 2009

Sector	Value (US $million)		% change of previous year	Number of Deals		% change of previous year
	2007	2008		2008 (Jan – Jun)	2009 (Jan – Jun)	
Primary	2,314	2,533	0.5	1,112,230		112.6
Agricultural & allied products	10	24	140	24		-100
Mining	1,239	421	-66	277	1,780	542.6
Oil & natural gas	1,065	2,088	96.1	110	450	309.1
Manufacturing	29,919	6,306	-78.9	5,394	319	-94.1
Food & beverages	1,269	56	-95.6	54		-100
Textile & apparel	126	136	7.9	136		-12.5

Paper and paper products		9		9	119	-100
Gems & jewellery	43	40	-7	40		-100
Rubber & plastic products	65	124	90.8	68		-100
Non-metallic mineral products	37	9	-75.7	9		-100
Metal & fabricated metal products	22,346	162	-99.3	162		-100
Machinery & equipment	1,351	173	-87.2	152		-100
Electrical machinery & equipment	1,560	827	-47	556	164	-70.5
Transport equipment	475	2,758	480.6	2,701	32	-98.8
Telecommunication equipment	757		-100			
Chemicals	1,117	1,427	27.8	1,087		-100
Pharmaceuticals	773	585	-24.3	420	4	-99
Services	3,350	3,989	19.1	2,137	265	-87.6
Business advisory	9		-100			
Media & entertainment	81	148	82.7	144	25	-82.6
Hospitality & tourism	521	45	-91.4	45	13	-71.2
Banking & financial services	26	141	442.3	110		-100
Telecommunication services	330	84	-74.5	84	26	-69

IT & ITES	2,383	2,565	7.6	786	201	-74.4
Power generation & distribution		1,006		968		-100
Others	244	126	-48.4	29		-100
Grand total	358,247	12,594	-63.8	7,971	2,814	-64.7

Sources: Based on a dataset constructed from reports from newspapers, magazines and financial consulting firms like Hindu Business Line, Economic Times, Financial Express, Business World, Grant Thornton India, and ISI Emerging Markets.

Table 4. Regional direction of Indian overseas acquisitions, 2008 and early 2009

Host Region	**Value (US $million)**		**% change of previous year**	**Number of Deals**		**% change of previous year**
	2007	**2008**		**2008 (Jan – Jun)**	**2009 (Jan – Jun)**	
Developing economies	3,234	685	-78.8	496	531	7.1
Africa	111	188	69.4	80	451	463.8
Latin America & Caribbean	232	68	-70.7	68		-100
Asia	2,891	429	-85.2	348	80	-77
Transition economies	37	20	-45.9			
Europe	37	20	-45.9			
Developed economies	32,556	12,249	-62.4	7,475	2,283	-69.5
America	14,372	3,570	-75.2	2,313	2,046	-11.5
Asia	492		-100			
Europe	17,579	8,122	-53.8	4,997	196	-96.1
Oceania	113	557	392.9	165	41	-75.2

Grand Total	35,827	12,954	-63.8	7,971	2,814	-64.7
Memorandum item						
Number of host countries	40	42		35	14	
Number of acquiring Indian companies	150	164		109	24	

Sources: Based on a dataset constructed from reports from newspapers, magazines and financial consulting firms like Hindu Business Line, Economic Times, Financial Express, Business World, Grant Thornton India, and ISI Emerging Markets.

Table 5. Indian overseas acquisitions by selected host countries, 2008 and early 2009

Host Economy	**Value (US $million)**		**% change of previous year**	**Number of Deals**		**% change of previous year**
	2007	**2008**		**2008 (Jan – Jun)**	**2009 (Jan – Jun)**	
UK	15,347	5,384	65.0	2,81	32	-98.8
USA	12,003	3,165	-73.6	1,932	2,045.94	5.9
Canada	1,805	405	-77.6	381		-100.0
Indonesia	1,124	258	-77.0	255	80	-69.0
Norway	900	302	-66.4	300		-100.0
Singapore	818	39	-95.2	22		-100.0
Republic of Korea	752		-100.0			
Germany	745	812	9.0	554	164	-70.4
Bermuda	564		-100.0			
Israel	489		-100.0			
Netherlands	355	954	168.7	954		-100.0

Brazil	224		-100.0			
Malaysia	133		-100.0			
Australia	113	557	392.9	165	41	-75.2
Mozambique	86	78	-9.3			
France	71	35	-50.7	2		-100.0
Italy	61	272	345.9	187		-100.0
Vietnam	44	2	-95.5			
Russia	37	20	-45.9			
Czech Republic	25	3	-88.0	3		-100.0

Sources: Based on a dataset constructed from reports from newspapers, magazines and financial consulting firms like Hindu Business Line, Economic Times, Financial Express, Business World, Grant Thornton India, and ISI Emerging Markets.

Table 6. Illustrative cases of overseas disinvestment by Indian firms, 2009

Indian Company	Action Taken
Suzlon Energy Ltd.	SEL sold 10% stake in Hansen Transmissions International on January 2, 2009 to raise Rs 600 crore (about USD120 million). According to news reports, Suzlon has taken this step because of the tight liquidity situation and its obligation to buy the stake of the Portuguese company Martifer in REpower, Germany.
Sakthi Sugars Ltd.	Sakthi Germany GmbH and Sakthi Sweden AB have filed for bankruptcy and Arvika Gjuteri AB, Sweden, for financial reconstruction. According to a parent company source, these measures were taken on account of the economic meltdown in the US and Europe and the consequent drastic reduction in orders.
Reliance Industries Ltd.	RIL's German subsidiary, Trevira GmbH, has started insolvency proceedings. RIL took this step to overcome the impact of the industrial slowdown in Europe, particularly in the automotive and textile sectors, to which it is an important supplier.
Vardhman Polytex Ltd.	VPL has decided to close down its Austrian subsidiary, FM Hammerle Nfg GmbH, as part of a business restructuring demanded by the current recession in Europe.

Sources: (i) Hindu Business Line (2009), "Suzlon Energy sells 10% stake in Hansen", January 3; (ii) Financial Express (2009), "Sakthi Sugars' European units file for bankruptcy", February 6; (iii) Economic Times (2009), "RIL's German textile arm files for bankruptcy", June 4; and (iv) BSE (2009), "Corporate communication of Vardhman Polytex", June 23.

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