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EMERGING TRENDS IN OUTWARD FDI AND PRELIMINARY EVIDENCE ON THE EFFECTS OF COVID-19 ON OUTWARD FDI FROM INDIA

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ABSTRACT

Investing overseas is a potential channel to access new distribution networks, enhance knowledge base and technology and improve competitiveness which can be crucial for a country's growth and development. (Dunning and Lundan, 2008). Last few decades have witnessed a growing trend of overseas investments by the developing countries, including India. This paper presents a trends analysis for outward FDI flows from India, using RBI database for the period 2007-2019. Since RBI provides a disaggregated monthly data, it is aggregated to yearly observations for the purpose of trends analysis. A sectoral and destination specific trends analysis brings out some important facts about Indian OFDI. Service sector dominates the Ooutward FDI flows from India and the increasing presence of primary sector is noteworthy. Emergence of destinations such as Singapore, UAE, Russia, Mozambique as compared to the earlier popular destinations such as U.S and U.K, is another significant finding of the paper. However, because of COVID-19, FDI outflows have been adversely affected. This paper highlights some emerging trends in FDI outflows, for Asian economies, followed by a detailed case study on changes in Indian overseas investment due to the global pandemic. The study includes a monthly, like for like, comparison of the overall Indian overseas investment. It also presents a disaggregated sector-wise and destination-specific analysis of the trends in Indian OFDI flows for 2019 and 2020, for the months of March-August. Trend analysis and calculations based on the data, show a fall in OFDI flows with services and its sub-sectors hit hardest by the pandemic, followed by the manufacturing

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sector. Primary sector reported a growth driven mainly by investments from ONGC Videsh Ltd. and Oil India Ltd. Pattern of OFDI flows patterns changed in favor of destinations like Mozambique, British Virgin Islands and South Korea in 2020.

Keywords: Outward Foreign Direct Investment; Emerging Trends; Covid-19; Asia; India

INTRODUCTION

The COVID-19 pandemic has led to a world-wide unprecedented situation where demand has fallen and so has supply- a simultaneous demand slowdown and a supply shock. Governments have been forced to shut down economic activity, causing the financial sector effects to spill over to the real sectors, strengthening the backward loop. According to a report by UNCTAD, the world economy is likely to shrink by a staggering 4.3 percent in 2020. Though, the situation is expected to be worse for the developed economies, developing economies are also expected to be severely hit by the pandemic. Unlike the 2008-09 recession, the report by UNCTAD predicts a negative growth rate of -2.1 percent for the developing countries in 2020 and a week recovery of +5.1 percent in 2021. However, two Asian economies, China and the Republic of Korea are forecast to grow at a weak, albeit positive rate of +1.3 percent and +0.3 percent respectively, in 2020.

In the wake of this global pandemic, countries are rethinking their international trade strategies, to reduce their vulnerability to global economic shocks and to move towards becoming self-reliant. De-Globalization seems to be the "New Normal" with domestic sourcing as the key word and country specific policies as the generally accepted norm. The rate at which this process can happen will depend on the extent to which restrictive FDI measures become binding and efficacy in relocation of supply chains to home markets. Many countries have undertaken restrictive trade and FDI policies, whose duration is not known, to limit the spread of virus. (Baldwin and Freeman, 2020). This has created an environment of social and political uncertainty for the multinationals. Some preliminary evidence suggests that this uncertainty can lead to a fall in FDI flows. (Inada and Jinji, 2020).

Investing overseas is considered to be a potential channel to access new distribution networks, enhance knowledge base and technology and improve competitiveness which can be crucial for a country's growth and development. (Dunning and Lundan, 2008). Last few decades have witnessed a growing trend of overseas investments by the developing countries. It grew from 13 billion USD in 1990 to 374 billion USD in 2019. India has emerged as one of the important developing countries that have increased their share of overseas investment in the last two decades. However, because of COVID-19, FDI outflows have been adversely affected. This chapter discusses some trends in FDI outflows post COVID-19, for Asian economies, followed by a detailed trend analysis of Ooutward FDI flows from India for the period 2007-2019, based on the dataset released by the RBI. Further, an analysis is done on the changes in Indian overseas investment due to the global pandemic that includes a monthly, like for like, comparison of the overall Indian overseas investment, a disaggregated sector-wise and destination-specific analysis of the trends in Indian OFDI flows for 2019 and 2020, for the months of March-August.

The paper is organized as follows. The next section discusses the trends in outward FDI flows including some preliminary evidence for post-COVID period, for Asian economies. Section II presents a trend analysis for the period 2007-2019 for Ooutward FDI from India. It also includes a Covid- comparison analysing the effects of COVID-19 on OFDI flows. Section III concludes.

TRENDS IN OUTWARD FDI - ASIAN ECONOMIES

Overseas investment flows from developing economies especially Asian economies have been increasing since the last two decades. The explanation of trans- border production by national firms is explained by numerous theories:

a) the industrial organisation theory (Hymer,1960; Caves, 1971), which asserts that a country invests abroad due to firm specific advantages such as ownership of technology not known to the rivals, product differentiation, management know-how and marketing and selling capabilities; b) theory of Ownership, location and internalisation (O-L-I) advantages for the home country of investing abroad (Dunning, 1977; 1981).

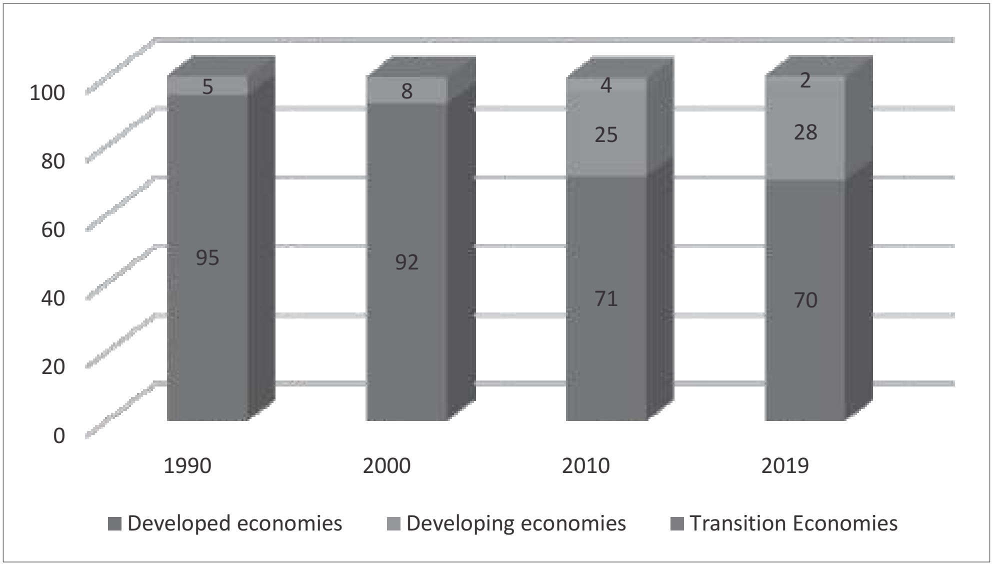
Resource seeking, strategic asset seeking, market seeking and efficiency seeking have been highlighted as the main motives behind a country's reasons for investing overseas (Dunning and Lundan, 2008).

> In case of emerging economies, an increasing share of OFDI, has become knowledge sourcing with the motive to explore and tap the foreign knowledge sources and gain access to newer and better technologies, distribution channels and even brand names.

Overseas investment flows from developing countries have been increasing since 1990's. From 13 billion USD in 1990 they increased to 414 billion USD in 2018. Though, 2019 reported a drop to 374 billion USD. The period from early 2000's witnessed a major upsurge in outward foreign direct investment from developing economies (Figure 1). Share of developing economies in world's OFDI increased from a mere 8 percent in 2000 to 26 percent in 2010. It reached the highest of 42 percent in 2018 before dipping to 28 percent in 2019.

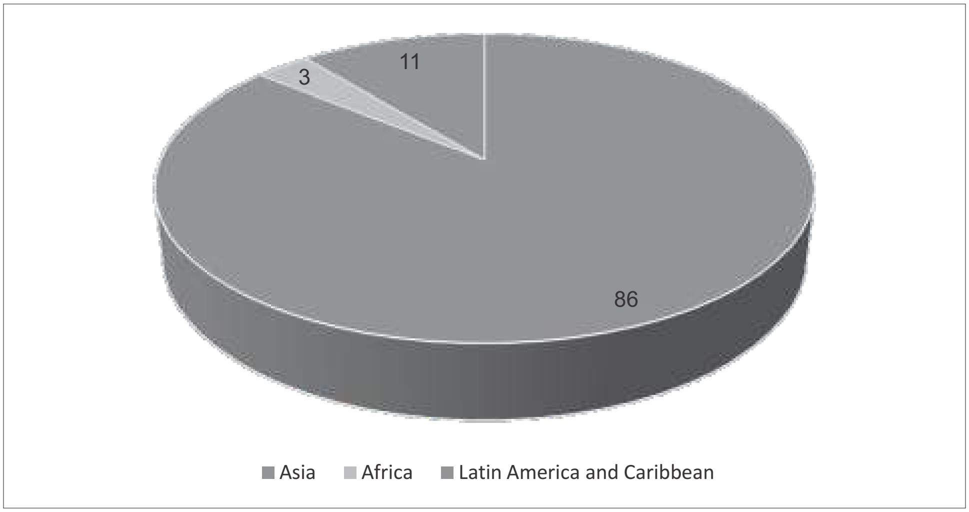
Within developing economies, Asia has been the leading region with highest average share of outward investment flows of around 86 percent for the period 1990-2019, followed by Latin America and the Caribbean, with an average share of 11 percent. Contribution of African economies in outward FDI flows from developing economies is around 3 percent for the same period, whereas average share of Oceanic countries has been negligible. (Figure 2).

Figure 1: FDI Outflows - % Share



Source: Author's calculations based on World Investment Report, United Nations, 2020

Figure 2 : FDI Outflows from Developing Economies 1990-2019 (Average % Share)



Source: Author's calculations based on World Investment Report, United Nations, 2020

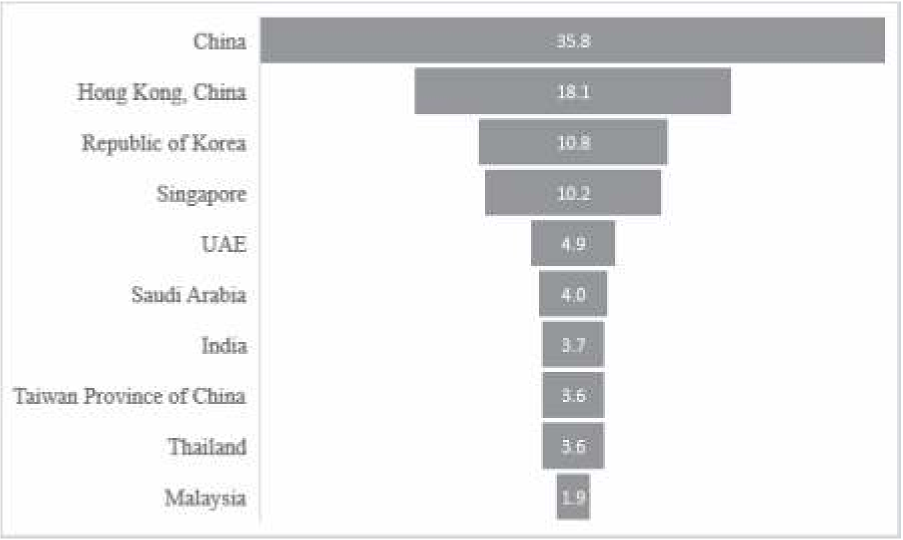
Within the Asian countries, although the FDI flows have been predominantly driven by East and South-East Asian countries, West Asia and South Asia have recorded a steady growth in % share of FDI outflows from Asia over the last three decades. Table 1 shows the share of FDI outflows for Asian Sub-Regions as a percentage of FDI outflows from Asia. West-Asian countries recorded a positive 10.8 percent share in 2019 as compared to a negative percentage share of 8.8 in 1990. South-Asian economies recorded the percentage share in FDI outflows from 0.6 percent in 1990 to 5.6 percent in 2010. It fell to 3.7 percent in 2019. FDI outflows from Asian economies have been dominated by China from East and South-East Asia, India from South-Asia and UAE from West Asia indicating the fact that the fastest growing economies in the world have been aggressively looking overseas to expand their asset and knowledge base . Figure 3 reports the top 10 Asian economies that have invested abroad in 2019, based on percentage share of FDI outflows from Asia.

Table 1: FDI Outflows: Sub-Regions of Asia (% Share)

	1990	2000	2010	2019
East and South-East Asia	108.2	95.6	88.4	85.4
South Asia	0.6	0.7	5.6	3.7
West Asia	-8.8	3.7	6.0	10.8

Source: Author's calculations based on World Investment Report, United Nations, 2020

Figure 3: Top 10 Asian countries : % Share in Asian FDI Outflows (2019)

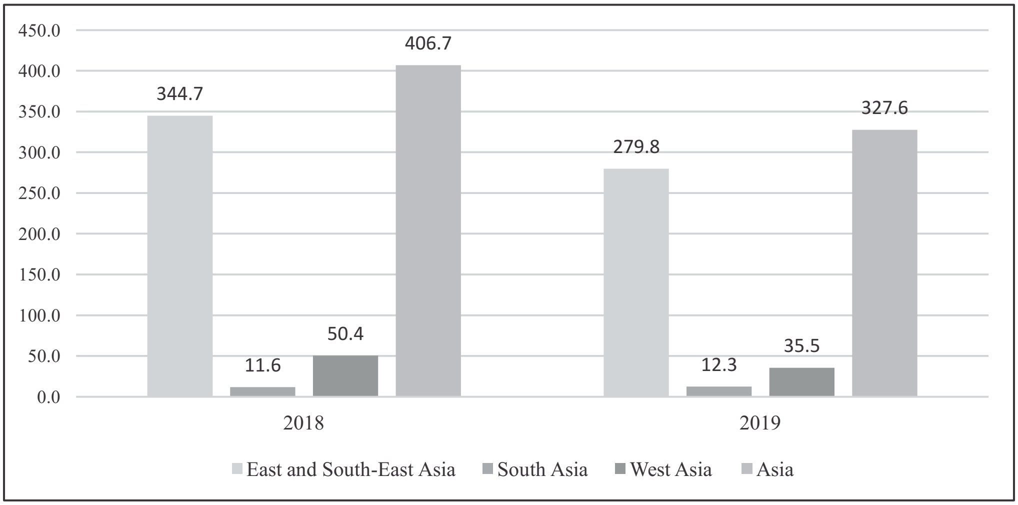


Source: Author's calculations based on World Investment Report, United Nations, 2020

OFDI has increasingly been understood as the means to access newer markets, enhance knowledge- base and acquire foreign assets. Hence more than 50 percent of the outward FDI from the Asian economies was targeted in the developed regions in 2012. (UNCTAD, 2014). Further, UNCTAD, 2020 reports that green field investments have dominated the form of FDI flowing out from the Asian economies, as compared to mergers and acquisitions.

In 2019, outward FDI from Asian countries fell by 19 percent from 2018. The main reasons attributed to this fall were decline in commodity prices, geopolitical unrest, and China's restrictions on outward FDI.

Figure 4: FDI Outflows: Asia and Sub-regions: 2018 and 2019 USD Billion



Source: Author's calculations based on World Investment Report, United Nations, 2020

Outflows from East and South- East Asia and West Asia in 2019 declined by 24 percent and 40 percent respectively. Outward investment from major economies like Hongkong (China), Thailand, the Republic of Korea and Saudi Arabia declined. Though, for the same period, outflows from South- Asia grew by nearly 6 percent, driven by investment from India. Singapore also reported an increase in outward investment.

Outward FDI flows are expected to further decline due to the liquidity crunch in these countries. With COVID-19, the year 2020, has witnessed a global shock which is expected to significantly change OFDI patterns.

Impact of COVID-19 on FDI Outflows

UNCTAD reports that trade and FDI flows have been adversely affected by the global pandemic in 2020 and are expected to deteriorate further in 2021. The report predicts a fall of around 40 percent in global FDI flows, from 1.6 trillion USD in 2019 to below 1 trillion USD in 2020; and a continued decline in cross border mergers and acquisitions. According to the latest report the flows from the developed countries to developing economies dropped by 16 percent in the first half of 2020. The fall was around 28 percent for Africa, 25 percent for Latin America and the Caribbean and 12 percent for Asia.

Report also confirms the value of greenfield investment project announcements- an indicator of future FDI trends – at 358 billion USD, in the first eight months of 2020. Developing economies registered a much bigger fall of 49 percent as compared to a fall of 17 percent for developed countries. The cross-border project finance deals declined by 25 percent decelerating the most in the third quarter of 2020 suggesting further deceleration.

The origin of the pandemic from China may also have some implications for the FDI flows in this region. Till the outbreak of the COVID pandemic, China had been one of the largest recipient economies of FDI (140 billion USD in 2019) with the world outflows of investment flowing to China's manufacturing sector. However, after COVID-19 outbreak in China, many foreign investors and foreign companies are moving out of China. FDI in China fell to 10.8 % (year over year) to 31 billion USD, in the first quarter of 2020. Investors are looking to invest in other Asian countries and India is being touted as the preferred destination for investment particularly in the manufacturing sector. During COVID-19, FDI in India increased by 2.8 billion USD and is expected to be around 4 billion USD by the end of next quarter in 2020. However, due to the lockdown in India in March 2020, the Micro, Small and Medium Enterprises (MSME's) which are the backbone of Indian industry, have been badly impacted, with around 25% of them shutting down and more than 60% unable to pay salaries due to shortage of funds. It is a grim situation for the Indian manufacturing, that would require some major policy initiatives to turn it around. "Make in India" initiative can be one such policy, to upgrade technology base of the sector and make it attractive for foreign investment. The role of QUAD economies and the extent to which they can influence the FDI flows in the region also assumes importance in this respect.

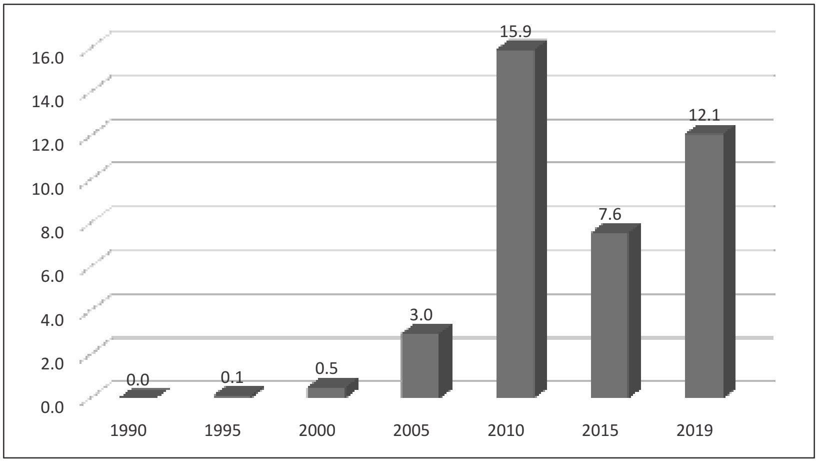
Although COVID-19 has impacted the manufacturing sector, services sector and its sub-sectors such as hotels and restaurants, transportation and storage are also likely to be severely affected by the pandemic.

The next section presents a detailed trend analysis of outward FDI flows from India. Since the RBI released the data on Ooutward FDI from 2007 onwards, the trend analysis is done for the period 2007-2019. Additionally, a like for like monthly comparison is done for 2019 and 2020 to get some preliminary evidence of the effects of Covid-19 on outward FDI flows from India. It includes a disaggregated study on OFDI outflows from the sectors, including primary, manufacturing and services sector. Further, a COVID comparison is also done for outward FDI flows from sub-sectors of services sector.

TRENDS OF OUTWARD FDI FROM INDIA

Outward investment from India began in the 1960's-mainly to developing countries like Sri-Lanka and few African countries- with a few business conglomerates including the Tata, Birla and the Kirloskar investing overseas. Following the economic reforms in 1991, which made significant domestic and foreign policy shifts, India's outward investment increased in the 1990's and surged in the consecutive decades (Figure 5). It recorded the highest value of 21 billion USD in 2008. It is among the top 10 Asian economies in terms of outward investment flows, and one of the few economies to report an increase in OFDI in 2019, when the Asian economies largely witnessed a fall in their overseas investment flows. India's share onin global FDI outflows increased from 0.0 percent in 1990 to 0.92 in 2019, while its share in developing countries' outflows was up from 0.05 percent to 3.2 percent and from 0.5 percent to 3.69 percent in the Asian countries for the same period. Its share in South-Asian countries' OFDI rose from a mere 9.18 percent in 1990 to a whopping 98.53 percent in 2019. India's Ooutward flows as a percentage share of GDP also rose from 0.0 percent in 2019 1990 to 0.46 percent in 2019 (Table 2). The increasing share of overseas investment from India in the last two decades clearly indicate the fact that India is emerging as a strong global player with the primary aim of acquiring assets and technology and augmenting its research and development (Pradhan and Singh, 2009; Das, 2013)

Figure 5: FDI Outflows - India USD Billion



Source: Author's calculations based on World Investment Report, United Nations, 2020

Table 2: India's FDI Outflows in a developing country context, 1990-2019

	1990	1995	2000	2005	2010	2015	2019
% Share in Global OFDI	0.00	0.03	0.04	0.35	1.15	0.47	0.92
% Share in Developing countries' OFDI	0.05	0.23	0.57	2.52	4.27	1.95	3.2
% Share in Asian Countries' OFDI	0.05	0.26	0.65	3.34	2.03	5.46	3.69
% Share in South-Asian Countries' OFDI	9.18	92.5	95.19	85.62	97.89	96.87	98.53
% Share in GDP	0.00	0.03	0.11	0.32	0.95	0.36	0.46

Source: Author's calculations based on World Investment Report, United Nations, 2020 and World bank data, 2020.

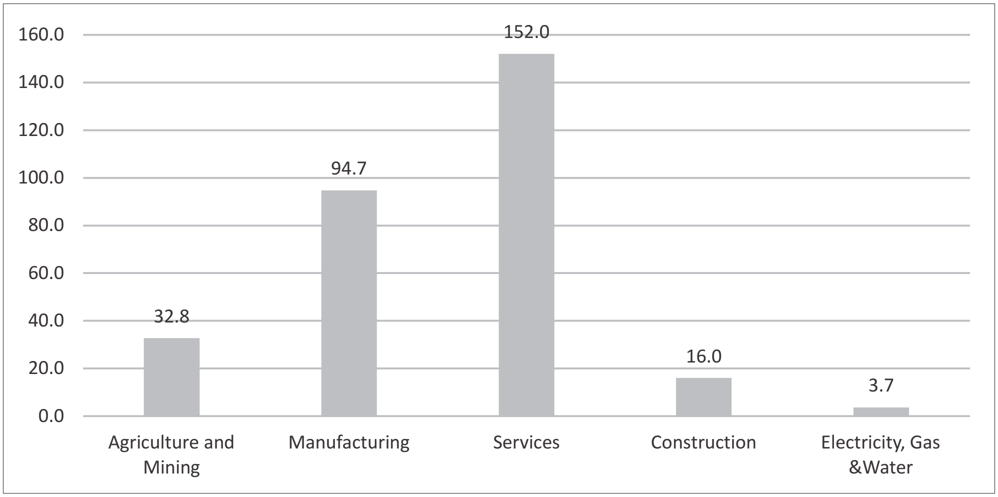
Trend analysis for the Indian OFDI is done in the next section. Data for outward FDI flows is taken from the RBI database on overseas investment obtained from www.rbi.org.in for India. It provides destination specific, sector-wise monthly disaggregated data for FDI outflows from July 2007 onwards. For the trend analysis, the monthly data was aggregated into yearly data for the period 2007-2019.

As revealed by figure 6, the cumulative total of OFDI originating from the services sector is the highest followed by the two sectors - manufacturing sector and agriculture & and mining. The cumulative flows OFDI flows accounted for 152 billion USD from the services sector whereas from the manufacturing sector the OFDI flows were around 95 billion USD. (Figure 6). Services sector has been a globally competitive and the leading sector for India' economic growth. Thus, the cause of it's increasing presence overseas can be related to the motive of expanding its market base and improving its competitiveness globally. Manufacturing sector has also been a large player in the global market investing overseas, possibly with the aim of exploring newer markets and also deriving efficiency gains by taking location specific advantages of the host countries. Noteworthy here, is the emerging primary sector (agriculture and mining), which hardly had any presence in overseas investment from India in the 1980's and 1990's. Though its share in absolute terms is small as compared to the services and manufacturing sectors, it's growth in the last two decades has been quite remarkable. This may be attributed to it's motive of acquiring natural resources such as oil and gas. India's economic growth and its dependence on for energy imports, mainly petroleum, have probably led this sector to explore opportunities in oil and gas extraction overseas.

The ownership pattern of overseas investments over the same period was dominated by WOS (wholly owned subsidiaries) accounting for nearly 75 percent of the Indian OFDI flows whereas JV's (joint ventures) accounted for 25 percent of total Indian OFDI flows measured cumulatively over the period 2007-2019. (Figure 7). Since Indian OFDI is dominated by the services sector, factors such as protecting firm-specific assets, maintaining confidentiality and close relationship with clients could be responsible for the dominant share of wholly owned subsidiaries as compared to

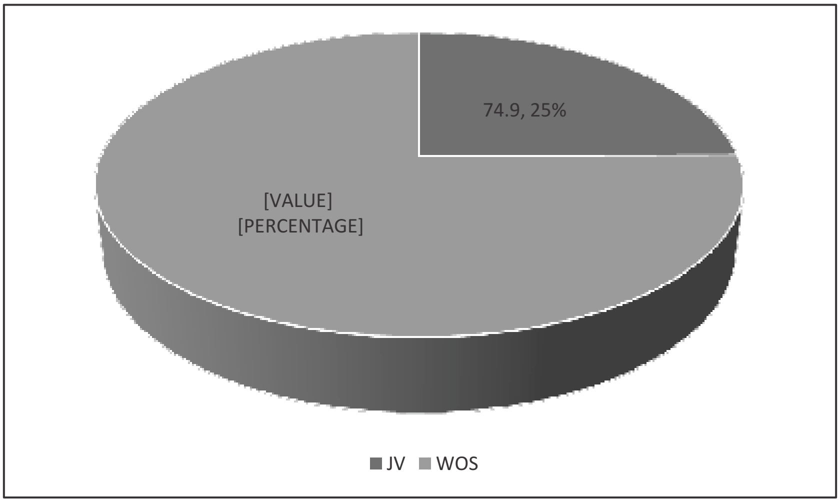
JV's which are certainly less risky.

Figure 6 : Cumulative FDI Outflows – India (2007-2019) USD Billion



Source: Author's calculations from Reserve Bank of India, Database.

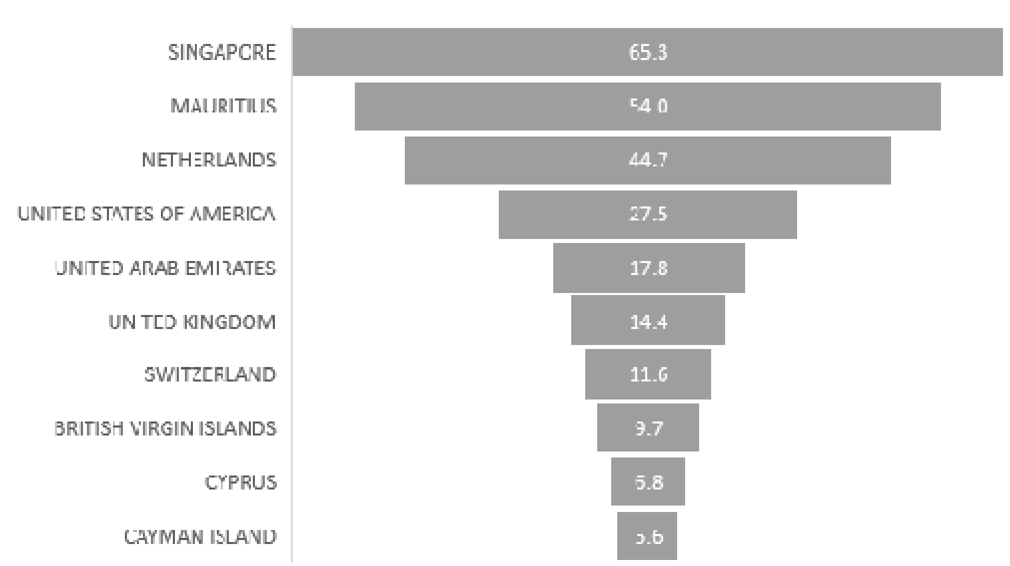
Figure 7 : Ownership pattern of cumulative FDI Outflows–India (2007-2019) USD Billion, Percentage



Source: Author's calculations from Reserve Bank of India, Database.

Trend analysis reveals that the top 10 destinations for the period 2007-2019 included Singapore, Mauritius, Netherlands, United states of America, United Arab Emirates, Switzerland, British Virgin Islands, Cyprus and Cayman iIsland (Figure 8). It is well known that Mauritius is popular as a tax haven for the investing firms. Emergence of Singapore and United Arab Emirates asmong popular destinations reveal a pattern shift from the erstwhile popular destinations such as U.S and U.K. Though U.S and U.K continue to be popular destinations yet the emergence of new regions such as UAE and British Virgin Islands is noteworthy. The reasons for Singapore an UAE to be the top destinations could be their geographical proximity, similar business environments and strong cultural and historical ties. Countries like Mauritius, British Virgin Islands and Cyprus offer an advantageous fiscal regime with low taxes also providing access to African markets.

Figure 8 : Top 10 Destinations for cumulative Indian FDI Outflows



Source: Author's calculations from Reserve Bank of India, Database

It is revealed from the above trends analysis, that the service sector has been the leading sector for Indian OFDI followed by manufacturing sector. It is important to study the impact of COVID-19 on OFDI flows as the pandemic can have adverse implications for the manufacturing as well as services sector. The next section analyzes the changes in volume of OFDI flows from the Indian economy, as well as sector specific changes in Indian OFDI flows that have been brought about the global pandemic.

A Covid- 19 Comparison

Table 3 presents a month on month, Like for Like comparison (LFL) of OFDI from India, between March and August, 2019 and 2020. The RBI monthly database on Indian overseas investments reports accurate data on financial commitments which may differ from the actual amount of FDI outflows. OFDI flows are reported as a sum of three components, equity, loans and guarantees issued. It has been reported, however, that percentage of guarantees invoked has been negligible. (Chaudhry et al, 2018). Hence, to get more accurate observations, sum of equity and loans is used as a measure of OFDI flows and guarantees issued are excluded from the analysis.

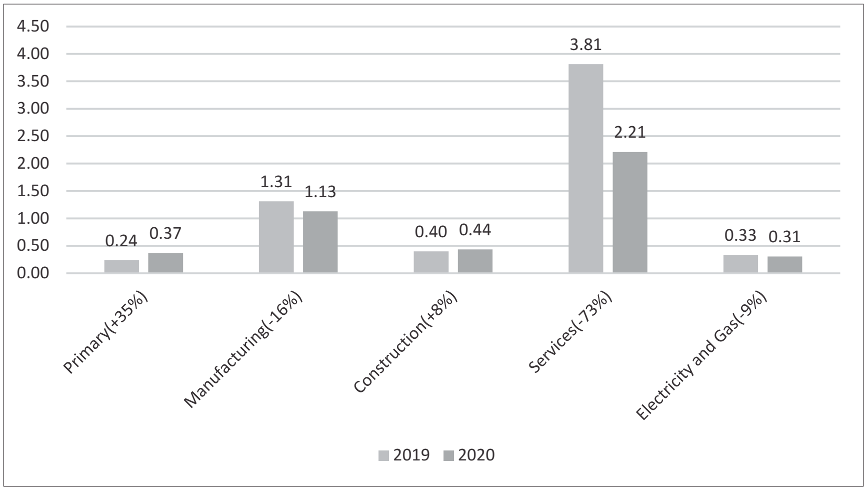
Results from calculations based on the data show that outward FDI flows from India are significantly lower from March-August, 2019 compared to March-August 2020, with a drop of around 35 percent over the six month period. OFDI fell sharply by nearly 40 percent for March, May, July and August. The OFDI flows from the services sector dropped from an aggregate of 3.8 billion USD to 2.2 billion USD, over the six-month period, while outflows from manufacturing sector fell from 1.3 billion USD to 1.1 billion USD, OFDI flows from the primary sector increased from 0.24 billion USD to 0.37 billion USD for the same period. (Figure 9).

Table 3: India's FDI Outflows: LFL Comparison (Covid-19 Impact)

Months OFDI(USD Million)	March 2019	March 2020	April 2019	April 2020	May 2019	May 2020	June 2019	June 2020	July 2019	July 2020	August 2019	August 2020
Equity(A)	1762.3	537.1	512.5	230.8	510.8	400.2	352.4	320.7	538.0	387.2	586.6	305.5
Loan(B)	536.3	829.8	437.6	586.4	546.8	212.1	219.3	161.6	602.6	303.5	245.5	186.9
Total(A+B)	2298.6	1366.9	950.1	817.2	1057.6	612.3	571.6	482.3	1140.6	690.7	832.1	492.3
% fall in 2020	40.5		14.0		42.1		15.6		39.4		40.8	
% fall in OFDI for March-August (Aggregate) from 2019 to 2020 --------- 34.9												

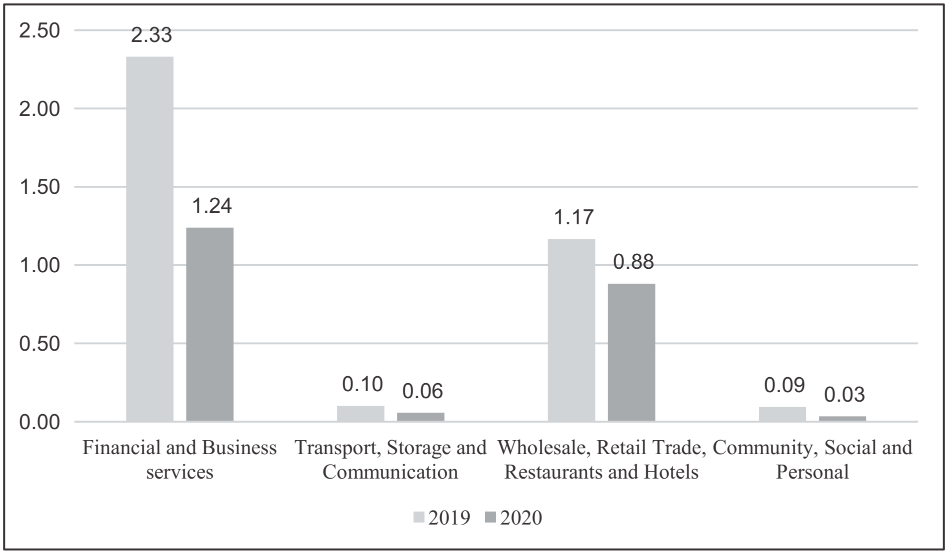
*S*ource: Author's calculations from Reserve Bank of India, Database.

Figure 9: Sector-Wise FDI Outflows: March-August (COVID-19 Impact) USD Billion



Source: Author's calculations from Reserve Bank of India, Database

Figure 10: Sub-Sector FDI Outflows (Services Sector): March-August (COVID-19 Impact)
USD Billion

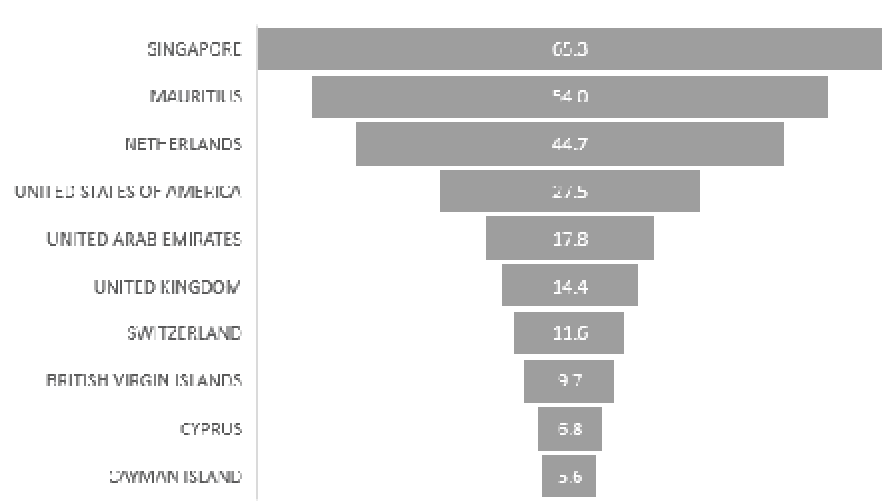


Source: Author's calculations from Reserve Bank of India, Database

As revealed by the above figures, the largest drop in OFDI flows was in the services sector, where overseas investment flows fell drastically by 73 percent over the period of six months in March-August 2020 compared to the same period in 2019 (Figure 9). A further disaggregation of the services sector reveals an across the board fall in 2020 to nearly half the amount in OFDI flows from 2019 in all sub-sectors (Figure 10). OFDI flows from Financial and business services which formed a major component of services, dropped significantly from 2.3 billion USD to 1.2 USD billion. Similarly, OFDI flows from transport, communication and storage sectors decreased from 0.1 billion USD to 0.06 billion USD, while outward flows from wholesale, retail trade, restaurants and hotels fell from 1.17 billion USD to 0.88 billion USD. Community, social and personal services were worst hit with OFDI flows dropping from 0.09 billion USD to 0.03 billion USD. Empirical evidence for India has suggested that OFDI flows have led to an increase in R&D expenditure and intensity for parent firms (Pradhan and Singh, 2009; Das, 2013; Roy and Narayanan, 2018). A fall in this sector's share of overseas investment can dampen the potential positive effects of OFDI for this sector.

The fall in OFDI flows from manufacturing sector and electricity and gas sector for the same period was 16 percent and 9 percent, respectively. It is important to note that, OFDI flows from agriculture and mining sector and construction for this period increased by 35 percent and 8 percent, respectively. Growth in the primary sector has been led by investments in Mozambique and British Virgin Islands by ONGC Videsh Ltd. and investments by Oil India Ltd. targeted mainly to British Virgin Islands (Figure 11). The importance of the primary sector clearly emerges from the fact that these regions were among top 10 destinations for OFDI flows from India in June 2020.

Figure 11: Top 10 Destinations for Indian FDI Outflows- % Share (June 2020)



Source: Author's calculations from Reserve Bank of India, Database

CONCLUSION SUMMARY

Overseas investment is an important source for connecting in a global market- place, to access newer markets and enhancing the knowledge-base. This paper presents a trend analysis for Indian OFDI flows and examines the short run impact of the pandemic on the same.

The paper concludes that services sector is the top sector dominating OFDI flows from India with primary sector also increasing its presence overseas. Ownership pattern for Indian OFDI flows is dominated by WOS relative to JV's.

Destination specific trends reveal Singapore as the most preferred destination for OFDI flows from 2007-2019. However, other destinations like UAE, Russia, Mozambique and South Korea have gained importance among top destinations for Indian OFDI in recent years.

COVID-19 has adversely impacted FDI outflows from India, with OFDI flows falling by nearly 35% in 2020 from 2019, from March-August. Services sector which has clearly emerged as the dominant sector was the hit hardest by the pandemic, with outward FDI flows, dropping by 73%, followed by the manufacturing sector, with OFDI falling by 19 percent. Within the services sector, all sub-sectors were severely affected by the pandemic with FDI outflows falling by 50 % or more for each sub-sector. Primary sector, however, reported a growth of 35% mainly driven by investments from ONGC Videsh Ltd. and Oil India Ltd.

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