Tread with Caution while Comparing Country Experiences of FDI Flows

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Introduction

India's FDI inflows are often compared directly with those of other developing countries, especially China. However, such comparisons have ignored not only the issues related to measurement and reporting, but perhaps more importantly, the critical issue as to the types of global capital flows that are labelled as FDI. Additionally, there are allied statistics in the form of cross-border M&As and greenfield investments which have their own major limitations and are not directly comparable with the reported aggregates. Significantly, the UNCTAD has commented on underlying problems associated with the statistics on FDI.

> Sound FDI data is an essential tool for research and policy analysis, and a basis for policy formulation, implementation and assessment. In fact, the scarcity, unreliability and inconsistency of FDI data pose a serious challenge for policy-makers, academics and practitioners.[1]

Another important factor is the nature of foreign investment for the developmental impact that this investment could bring critically depends upon it. The need for disaggregated global FDI statistics has been emphasised directly and indirectly many times. As Nunnenkamp and Spatz said,

> It is surprisingly hard to come by conclusive evidence supporting the widely held view that developing countries should draw on foreign direct investment to spur economic development. Virtually all empirical studies on the subject have found the impact of foreign direct investment on growth to be ambiguous because of the highly aggregated data they have used.[2]

On his part, Theodore Moran said:

> The use in these studies of aggregate data is like asking whether or not the FDI tree produces fruit punch (apples, oranges, bananas, and pears)? Or, more to the point, using aggregate data is like trying to find the common relationship between the impact of FDI on the oil industry of Nigeria ..., the impact of FDI in the electrical power industry of Indonesia... , the impact of FDI in the

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1 http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics-Bilateral.aspx

2 Peter Nunnenkamp and Julius Spatz, "FDI and economic growth in developing economies: how relevant are host-economy and industry characteristics", *Transnational Corporations*, Vol. 13, No. 3, December 2004, pp. 53-86.

> electronics industry of Malaysia ..., and the impact of FDI by Wal-Mart in the retail service sector of Mexico...
> Similarly, efforts to model FDI as a homogenous phenomenon and test with data that combine diverse kinds of FDI have to be restructured.[3]
> ....
> The policy message that emerges is far more complex and nuanced than the much criticized prescription of the "Washington consensus" that foreign investment flows are good, and the more FDI the better.[4]

In light of the above observations, we shall seek to explain some of the key problems in the FDI statistics and their presentation in the following discussion. The objective of this discussion is to help the readers appreciate the need for a disaggregated analysis of the issues centring on FDI. The objective is also to underline the need for India to interpret international data cautiously and to develop a statistical system of her own that captures all the relevant data.

Available data sources report that global FDI inflows consist mainly of foreign investments made in a new facility (Greenfield investment[5]), takeover of running enterprises in host territories (mergers and acquisitions, or M&As), profits retained in the host countries and other capital – primarily loans given by the parent companies to their foreign affiliates. Distinguishing Greenfield and M&A investments can be extremely problematic for the following reasons. First, not all reported the reported M&A deals are associated with change of control over the enterprises involved in such deals. Secondly, investments into new facilities or for acquiring existing enterprises can be made in different tranches, due to which the difference between the two may get blurred. Another conceptual problem arises because of the time factor: it is usual for FDI inflows to come in various tranches into a single project, interspersed over time. The question therefore is, for how long after an initial inflow into a new facility should subsequent inflows be treated as a part of the Greenfield investment? One of the responses to this question is provided by the Direct Investment Technical Expert Group (DITEG) of IMF-OECD. According to the DITEG, "an investment will cease to be classified as greenfield 4 to 5 years after the initial investment. However, there are no agreed standards on this and other related items".[6]

The OECD Benchmark Definition discusses some further possibilities, which make it difficult to make precise classification of inflows into M&A and Greenfield. Thus, mere deduction of M&A related inflows from the total inflows does not necessarily provide the data on Greenfield investments, especially if one is looking for

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3 Moran, Theodore H. (2011-04-15). *Foreign Direct Investment and Development: Launching a Second Generation of Policy Research: Avoiding the Mistakes of the First, Reevaluating Policies for Developed and Developing Countries* (Kindle Locations 317-318). Peterson Institute for International Economics. Kindle Edition.

4 *ibid*. (Kindle Locations 3599-3600).

5 UNCTAD, however, FDI involved "purchase of in fixed assets, materials, goods and services, and to hire workers in the host country" also as greenfield FDI.

6 Direct Investment Technical Expert Group, "Mergers and Acquisitions (M&As) Greenfield Investments and Extension of Capacity", Issue Papers 4, 28 and 29. IMF Committee on Balance of Payment Statistics and OECD, "Workshop on International Investment Statistics", Revised November 2004, p. 4

creation of new facilities by foreign investors. This is because, besides M&A activities and investment in new facilities, foreign funds can also be used for capital restructuring by retiring the debt or for meeting working capital needs. Equally importantly, in case of both cross-border Greenfield and M&A investments, the basic information used by UNCTAD is gathered by private agencies[7] which suffer from issues of concepts, coverage, completeness in terms of details and follow up.[8] Very often information on crucial points like size of investment and value of the deal is either estimated or left out. IMF had noted that

> Data on cross-border M&A transactions are published in UNCTAD's World Investment Report and are based on information provided by Thomson Financial, a private commercial database. Although M&A data reported by commercial databases are widely used by the financial press and other users of business statistics, studies undertaken by the OECD and European Central Bank (ECB) indicate that these cannot be used as a source for FDI data.[9]

In case of private equity investment, instead of the amount of FDI involved, the total investment from all sources is reported.

Reinvested Earnings

The second major component of the reported inflows is reinvested earnings. Even though, they are not cross-border flows, these are treated as a part of FDI inflows because these are net additions to the stock of capital held by foreign companies in their host countries. Size of reinvested earnings could be a function of the stock of FDI, duration of investment, profitability and investment opportunities offered by the host country vis-à-vis other countries. These in turn can be deployed either to expand/improve the existing business, set up new facilities or to acquire businesses from other entities, wholly or in part. Further, there can be two contrasting views about reinvested earnings. The first is that foreign companies' reinvested earnings augment domestic investment in host countries and therefore the latter should devise policies that encourage foreign investors to retain more of their profits because dividend remittances act as a drain. The other view is that retained earnings increase the host country's liabilities without actually transferring resources from abroad. In fact, retained earnings are surpluses generated by the foreign companies in the host countries, which are in domestic currencies. These local currency denominated resources are then converted into foreign currency assets and can thus become the conduits for larger volumes of outflows through higher dividend remittances in future. Further, if such earnings are used to take over domestic companies or to buy

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7 For instance, one may refer to the sources mentioned in the annual World Investment Reports of UNCTAD. UNCTAD may refine the data but the basis sources are private database compilers.

8 For instance, see: UNCTAD, "UNCTAD Training Manual on Statistics for FDI and Operations of TNCs", Vol. 1, FDI Flows& Stocks, 2009. The Manual says:
Administrative information from government bodies responsible for approving M&As by non-residents should be used with caution. The same applies to commercial databases ... The M&A values are normally the acquisition prices and do not represent international flows of financial capital. Moreover, these are the values that are submitted at the application stage, and do not necessarily represent the actual amounts on completion of the M&A deal. (p. 115)

9 IMF, *Foreign Direct Investment Trends, Data Availability, Concepts, and Recording Practices*, 2004, Pp. 21-22.

back shares from the public, then they would not add to the existing capacities directly. Interestingly, UNCTAD says that

> "...earnings retained in the economy do not automatically translate into capital expenditures. For host countries of FDI, the same measures that promote investment will help maximize the extent to which retained earnings are reinvested. In addition, some countries adopt targeted incentives to facilitate reinvestment". (UNCTAD, *World Investment Report*, 2013, p. 36)

It should be underlined that reinvested earnings have emerged as an important component of the reported global FDI flows. However, their role is not highlighted enough possibly because of unavailability of disaggregated data, especially for the developing countries. It is only for some time now that UNCTAD has started reporting indicative shares of reinvested earnings. UNCTAD's data suggest that the share of reinvested earnings has increased progressively during the recent past and by 2013 they constituted two-thirds of the FDI outflows from the developed countries (See Table-1). For select developed countries the share is reported to have increased to as much as four-fifths of total inflows in 2014. In 2014 a mere 10 per cent of total inflows were accounted for by direct equity flows, with loans making up for the remaining part. (Table-2) Reinvested earnings are also reported to be accounting for a fairly large share of outward investments by developing countries. However, since UNCTAD's compilation does not contain data for economies like China, South Africa and Russia, these could be taken only as indicative.

An exercise conducted by us provides further support to the above phenomenon. For a set of 15 large developed country global investors, the average share of reinvested earnings in equity outflows worked out to be 57.5 per cent during 2011-2013 – far higher than the corresponding share of 40.6 per cent during 2005-2007, *i.e.*, the three years immediately preceding the financial crisis (See Table-3). Another important feature is that outflows as a ratio of dividend income received by the developed countries declined steeply over the three periods. In the pre-crisis period, they just matched the dividends. The ratio fell to almost two-thirds in the recent period. Thus more money was flowing into the developed countries as dividend income than that was flowing out as direct investment, thanks to the past investments. The relative flows with regard to developing countries are, however, not separately available. Developed country entities control the market for proprietary technologies and consequently, they are the main recipients of the payments made for using these technologies. Indeed, during 2011-2013, the high income OECD countries accounted for 96.2 per cent of the receipts under the head "Charges for the use of intellectual property". They were also the major spenders on high technologies having a share of 70.9 per cent of the total spending. United States alone accounted for about half (51.4 per cent) of the global receipts arising from the use of proprietary technologies. The country's share in payments was only 15.0 per cent.

Table 1: Growing share of Reinvested Earnings in FDI Outflows from Developed and Developing Countries (Percentages)

Year	*Developed Countries**			*Developing Countries#*		
	Reinvested Earnings	*Equity Outflows*	*Other Capital*	*Reinvested Earnings*	*Equity Outflows*	*Other Capital*
2007	35	52	13	32	47	21
2008	22	48	30	37	40	23
2009	46	49	4	47	53	0
2010	53	46	1	40	53	7
2011	46	44	10	45	45	10
2012	62	36	1	46	31	23
2013	67	23	10	55	44	1

* Relating to Belgium, Bulgaria, Czech Republic, Denmark, Estonia, Germany, Hungary, Japan, Latvia, Lithuania, Luxembourg, Netherlands, Norway, Poland, Portugal, Sweden, Switzerland, United Kingdom and the United States.

Albania, Algeria, Antigua and Barbuda, Armenia, Belarus, Belize, Plurinational State of Bolivia, Brazil, Chile, Colombia, Dominica, El Salvador, Georgia, Grenada, Guatemala, Hong Kong (China), India, Indonesia, Kazakhstan, Lesotho, Libya, Mongolia , Montenegro, Namibia, Nicaragua, Nigeria, Pakistan, Philippines, Republic of Moldova, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Serbia, Taiwan Province of China, TFYR of Macedonia, Thailand, Ukraine and Uruguay.

Source: UNCTAD, "Global Investment Trends Monitor", No. 16, April 28, 2014.

Table-2: Composition of FDI Outflows from Developed Countries (Percentages)

Year	*Percentage Shares*			*Reported Outflows (bn.)*	*Estimated Equity Outflows (bn.)*
	Reinvested Earnings	*Other Capital*	*Equity Outflows*		
2009	50	5	45	819	369
2010	59	1	40	963	385
2011	51	9	40	1156	462
2012	62	4	34	873	297
2013	74	6	17	834	142
2014	81	9	10	823	82

Based on the information provided in UNCTAD, "Global Investment Trends Monitor", and World Investment Report Annex tables.

Table-3: Shares **of Reinvested Earnings in Equity Outflows: 15** Select **High Income Counties**

Investing Country	*Equity Outflows ($ bn.)*	*Share of Reinvested Earnings in Equity Outflows (%)*		
	2011-2013	*2005-2007*	*2008-2010*	*2011-2013*
Belgium	85.4	21.7	38.3	-7.6
Canada	153.0	37.7	59.5	50.5
Denmark	27.4	37.3	-1.2	7.1
France	110.7	33.5	42.5	32.9
Germany	233.0	34.8	25.9	53.4
Italy	69.9	9.7	45.6	37.3
Japan	339.9	33.0	28.6	19.3
Netherlands	78.6	6.3	-3.1	28.3
Norway	54.4	21.6	16.4	3.5
South Korea	80.3	8.6	21.0	31.7
Spain	96.1	35.1	77.8	62.5
Sweden	76.1	36.9	58.1	54.1
Switzerland	110.3	35.5	54.2	55.2
United Kingdom	131.3	59.7	43.9	64.6
United States	1,072. 7	58.4	88.2	87.7
Total of the above	2,719.2	40.6	43.6	57.5

Source: Based on the data provided in IMF, Balance of Payments Statistics Yearbook, 2013 and 2014.

Private Equity and M&As

The reported global aggregates also fail to make a distinction between different types of investors even though existence of varied types has been well recognised. Financial investors and round-tripping investments by host country investors are the major types which do not conform to the traditional way of looking at FDI. Over and above this, investors' preference to use special purpose vehicles either to take advantage of preferential trade and investment agreements, tax advantages, regional bases set up for organisational convenience, or to maintain anonymity blur the distinction between home and host countries. The importance of private equity investments and their role in M&As can be gauged from the following observations of UNCTAD.

- Private equity FDI keeps its powder dry in 2013, outstanding funds of private equity firms increased further to a record level of $1.07 trillion, an increase of 14 per cent over the previous year.
- However, their cross-border investment – typically through M&As – was $171 billion ($83 billion on a net basis), a decline of 11 per cent. Private equity accounted for 21 per cent of total gross cross-border M&As in 2013, 10 percentage points lower than at its peak in 2007.
- With the increasing amount of outstanding funds available for investment (dry powder), and their relatively subdued activity in recent years, the potential for increased private equity FDI is significant.
- Though relatively small, developing-country-based private equity firms are beginning to emerge and are involved in deal makings not only in developing countries but also in more mature markets.[10]

While most private equity investments are treated as M&A deals, they themselves lead subsequently to actual acquisitions by others. At times, one private equity investor could be replaced by another private equity (PE) investor. Private equity related M&As in fact, entail regular and huge reverse flows due to periodic encashment of the earlier investments (See Table-4). Except for 2009, the share of reverse flows on account of encashed investments was close to half or more of the gross inflows. For the ten year period 2005-2014, the share was 57.1 per cent. In spite of the fact that FDI inflows include a sizeable portion of those related to M&A activities, most of which do not contribute to capital formation in the immediate or even in the medium term, the ratios of FDI inflows to gross fixed capital formation (GFCF) are used as indicators of the contribution of FDI inflows in augmenting the capital base of their host economies. The reported ratios of FDI inflows to GFCF, which though at times may appear to be high, could in fact be exaggerating the role of FDI in their host economies, more so when there were significant secondary investments by PE investors or those were replacing the domestic investors. In any case, a significant portion of the surpluses that could be ploughed back into the economy would be drained out. Despite these above-mentioned issues relating to the "actual" contribution of FDI to their host economies, this form of investment never exceeded

[10] UNCTAD, *World Investment Report*, 2014, p. xvii.

15 per cent of the gross capital formation for the developing countries taken as a whole, while for large economies like India and China, the ratios were well below 10 per cent for most years between 2001 and 2013 (See Table-5).

Table-4: Cross-border M&As by Private Equity Firms

Year	*Gross M&As ($ bn.)*	*Net M&As ($ bn.)*	*Share of Cashed in earlier Investments (%) (2)-(3)/(2)*100*
(1)	(2)	(3)	(4)
2005	202	103	49.0
2006	259	115	55.6
2007	528	279	47.2
2008	437	103	76.4
2009	105	62	41.0
2010	144	66	54.2
2011	155	66	57.4
2012	188	63	66.5
2013	169	82	51.5
2014	200	85	57.5
2005-2014	2,387	1,024	57.1

Source: Based on UNCTAD, *World Investment Report*, 2015, Table 1.3, p. 15.

Table-5: FDI Inflows as Percentage of Gross Fixed Capital Formation (percentages)

Year	*Developing economies*	*India*	*Brazil*	*China*	*Russian Federation*	*South Africa*
2001	13.8	4.7	23.8	10.3	4.7	38.7
2002	10.1	4.6	20.0	10.0	5.6	9.6
2003	10.0	2.8	12.0	8.3	10.0	2.8
2004	11.9	2.7	17.0	7.7	14.0	2.3
2005	12.1	2.9	10.7	8.0	11.3	16.0
2006	12.9	6.6	10.5	6.6	20.2	-1.1
2007	14.3	6.2	14.5	6.1	20.5	9.9
2008	13.3	10.8	14.3	5.9	20.2	14.6
2009	10.1	7.9	8.9	4.1	13.6	12.3
2010	10.2	4.8	11.6	4.2	13.1	5.2
2011	9.8	5.6	14.0	3.7	13.4	5.6
2012	9.1	4.0	16.0	3.1	11.3	6.2
2013	9.2	4.7	15.7	2.9	17.0	12.2

Source: UNCTAD FDI Statistics database.

Note: Value on a net basis takes into account divestments by private equity funds and it is calculated as Purchases of companies abroad by private equity funds less Sales of foreign affiliates owned by private equity funds. The table includes M&As by hedge and other funds but excludes sovereign wealth funds.

Non-Uniformity in Reporting across Countries and China's Case

Yet another factor that reduces the appropriateness of cross-country comparisons is the different methods adopted by various countries in reporting FDI statistics. Even the developed country data are not strictly comparable. As is well known, India was not including reinvested earnings and other capital till 2000-01. More importantly, even after starting to report the inflows according to international best practices, India has not adopted the basic criterion advocated by the international agencies *i.e.* minimum the 10% voting share required to identify FDI relationship. Tables 6 & 7 illustrate the different methods adopted by various developed and developing countries to measure FDI.[11] It may be noted that even US and UK do not follow the same approach and some countries follow different methods for inflows and outflows.

Table-6: Determination of the direct investment relationship: Differing Practices (IMF-CDIS)

Possible Answers	*Framework for Direct Investment Relationships (FDIR)*		*Participation Multiplication Method (PMM)*		*Direct Influence/Indirect Control Method (DIIC)*		*Do not use any such approaches as only capture data for enterprises at the first level in the chain of ownership*	
Type(s)	*Inward*	*Outward*	*Inward*	*Outward*	*Inward*	*Outward*	*Inward*	*Outward*
Germany	X	X						
Korea, South	X	X						
South Africa	X	X						
United Kingdom	X	X						
Hong Kong	X	X						
Brazil	X					X		
Indonesia	X							
Canada		X					X	
Russia			X	X				
United States			X	X				
Singapore			X					
France					X	X		
China							X	
India							X	X
Japan							X	X
Philippines							X	X
All Countries	43	31	12	7	10	8	18	12

Source: Based on the information accessed from the IMF website during middle of 2014.
For a description of the different methods one may refer to IMF, The Coordinated Direct Investment Survey Guide – 2015: Pre-Publication Draft accessed at https://www.imf.org/external/np/sta/pdf/cdisguide.pdf

11 IMF, *Foreign Direct Investment Statistics: How Countries Measure FDI*, 2001

Table-7: Primary Method Used in Valuing Unlisted Equity (IMF-CDIS)

Possible Answers	*Historic cost*		*Own funds at book value*		*Net asset value*		*Recent transaction price*	
Type(s)	*Inward*	*Outward*	*Inward*	*Outward*	*Inward*	*Outward*	*Inward*	*Outward*
Australia					X	X		
Austria			X	X				
Brazil		**X**	**X**					
Hong Kong			X	X				
China	X							
India			X	X				
Japan			X	X				
Kazakhstan	X	X						
Netherlands			X					X
New Zealand					X	X		
Singapore			X					
Spain			X	X				
Tanzania			X					
United Kingdom			X	X				
United States	X	X						
Total	6	4	79	52	4	4	1	1

Source: See Table-6

Table-8: Data Sources for Financial & Non-financial Corporations: Select Countries (IMF-CDIS)

Possible Answers	*Census*		*Sample*		*Both*	
Countries	*Inward*	*Outward*	*Inward*	*Outward*	*Inward*	*Outward*
Hong Kong			X	X		
China	X					
India	X	X				
United Kingdom			X	X		
United States					X	X

Source: See Table-6

The differences in investing and recipient countries are well reflected from the bilateral FDI statistics compiled by the UNCTAD. In some cases the two figures just do not match. (Table-9) It can be seen that in case of most developed countries, the outflows to India are far higher than that recorded by India. On the other hand, against more than $8 bn. reported by India, Mauritius in turn shows that its investment in India during the year was a mere $10 mn. Such large discrepancies can be seen in case of other countries like Bangladesh, Malaysia, Singapore and Thailand. While Luxembourg reported nearly $8 bn. outflows to Bangladesh, the country's inflows data is silent in this respect. It is the other way round in case of investments from Malaysia and United Kingdom.

Table-9: Imbalances of FDI Inflows as Reported by Host and Home Countries, 2012: Illustrative Cases

($ mn.)

Home Country	As Reported by the Host Country	As reported by the Home Country
	Host: India	
Australia	34.9	471.1
Belgium	32.8	154.2
China	148.2	276.8
Cyprus	415.3	48.8
France	547.3	57.8
Germany	467.2	2,081.5
Italy	62.9	1,420.4
Japan	1,340.1	2,792.3
Korea, Republic of	224.0	656.7
Luxembourg	33.7	708.0
Malaysia	237.7	165.0
Mauritius	8,058.6	10.3
Netherlands	1,713.2	-508.2
Poland	517.0	34.2
Russian Federation	0.1	274.7
Spain	347.9	299.4
Sweden	10.3	155.1
Switzerland	268.2	800.4
Thailand	4.6	95.5
United Kingdom	1,021.5	568.7
United States	477.8	4,086.0
	Host: Bangladesh	
Luxembourg	-	7,894.2
Malaysia	247.4	-
United kingdom	136.9	-
	Host: Malaysia	
Australia	645.6	933.9
China	15.0	199.0
Germany	487.3	-197.9
Luxembourg	40.7	1,274.6
Netherlands	845.1	-
United Kingdom	-1,586.9	383.9
United States	79.2	2,309.0
	Host: Singapore	
Australia	779.1	1,484.8
China	3,406.4	1,518.8
Denmark	1,738.4	-2,313.3
Japan	5,830.5	1,608.0
Luxembourg	2,801.1	6,796.9
Netherlands	7,482.4	-
Russian Federation	-	1,262.2
Thailand	1,778.7	497.7
United Kingdom	-14,549.0	-1,676.0
United States	11,249.3	16,083.0
	Host: Thailand	
Australia	141.3	-45.6
Germany	191.5	377.7
Italy	27.2	242.4
Japan	5,077.0	581.5
Netherlands	1,144.1	-
United Kingdom	-14.5	235.4
United States	1,136.1	2,428.0

Source: Based on the presentation "Need of reliable data: as a user's point of view" by Masataka Fujita and Astrit Sulstarova (both belonging to UNCTAD's Division on Investment and Enterprise) at the **Workshop on Enhancing the Scope and Quality of Indian FDI Statistics** organized by NCAER during March 10-11, 2015 at New Delhi.

Another major issue noted by UNCTAD was with regard to the threshold of foreign share for reporting an investment as FDI.

> China's FDI statistics deviate significantly from international standards. For example, the threshold level applied in the definition of FDI is 25%, rather than 10%, as recommended by the International Monetary Fund (IMF).[12]

Yet another dimension of Chinese FDI is that a number of Chinese companies belonging to both public and private sectors are listed on the Hong Kong Stock Exchange (HKEX) and the funds raised on HKEX are brought into the homeland as FDI. British Virgin Islands and to a lesser extent Cayman Islands also play an important role. Thus there has been a two way flow of investments by Chinese nationals, diaspora and foreign portfolio capital raised on the Hong Kong stock exchange. (Table-10 and Diagram-1) To the extent countries like Hong Kong and British Virgin Islands facilitate transhipment FDI, these tend to overestimate the global aggregates and ratios and as the investments are cancelled out the actual cross-border FDI flows would turn out to be far lower than the aggregates put out by the international agencies.

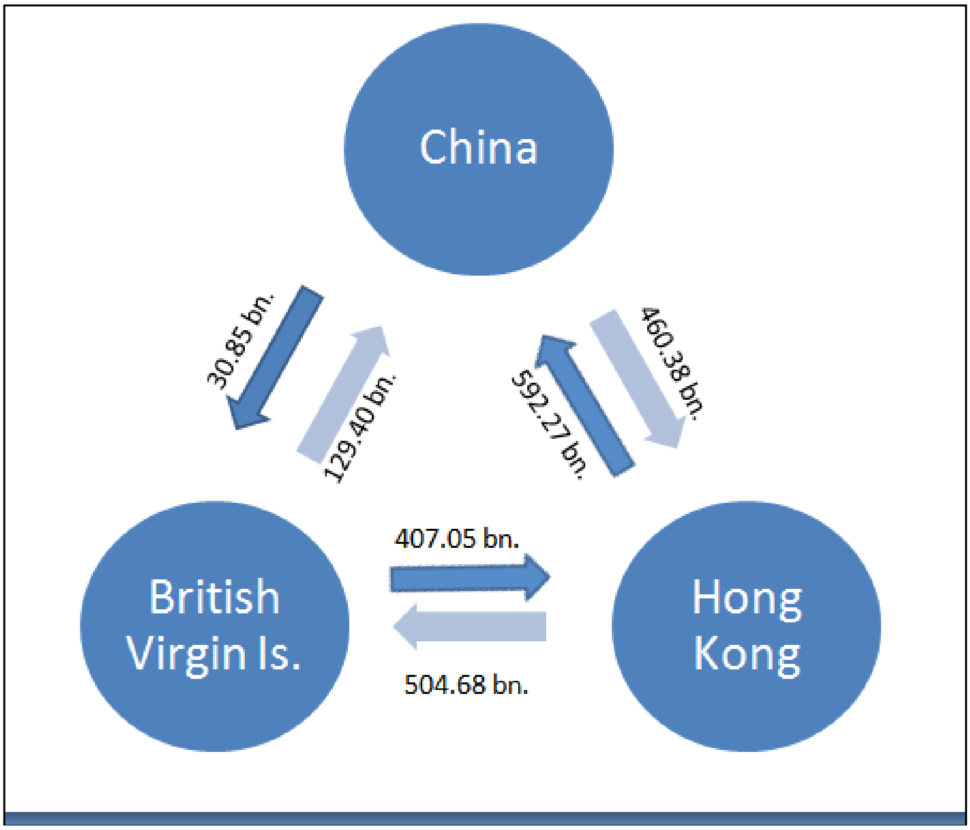
Table-10: China's Inward & Outward FDI Stock & Flows: Top Countries (2012)

	Origin	*US$ bn.*	*Share in Total (%)*	***Destination***	*US$ bn.*	*Share in Total (%)*
	Inward FDI Stock			**Outward FDI Stock**		
1	Hong Kong	592.2	48.4	Hong Kong	306.4	57.6
2	British Virgin Islands	129.4	10.6	British Virgin Islands	30.9	5.8
3	Japan	87.2	7.1	Cayman Islands	30.1	5.7
4	United States	70.2	5.7	United States	17.1	3.2
5	Singapore	59.3	4.8	Australia	13.9	2.6
6	Taiwan	57.0	4.7	Singapore	12.4	2.3
7	Republic of Korea	52.9	4.3	Luxembourg	9.0	1.7
8	Cayman Islands	25.8	2.1	United Kingdom	8.9	1.7
9	Samoa	19.9	1.6	Kazakhstan	6.2	1.2
10	Germany	19.8	1.6	Canada	5.0	0.9
	Total incl. others but excl. unspecified	1,224.1	100.0		531.9	100.0
	FDI Inflow			**FDI Outflow**		
	Origin			**Destination**		
1	Hong Kong	65.6	62.8	Hong Kong	51.2	58.3
2	British Virgin Islands	7.8	7.5	United States	4.0	4.6
3	Japan	7.4	7.1	Kazakhstan	3.0	3.4
4	Singapore	6.3	6.0	United Kingdom	2.8	3.2
5	Republic of Korea	3.0	2.9	British Virgin Islands	2.2	2.5
6	Taiwan	2.8	2.7	Australia	2.2	2.5
7	United States	2.6	2.5	Singapore	1.9	2.2
8	Cayman Islands	2.0	1.9	Venezuela	1.5	1.7
9	Samoa	1.7	1.6	Indonesia	1.4	1.6
10	Germany	1.4	1.3	Luxembourg	1.1	1.3
	Total incl. others but excl. unspecified	104.5	100.0		87.8	100.0

Based on the data available at http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics-Bilateral.aspx

12 *Ibid.*

Diagram -1: Cross-Ownership of FDI Stocks among China, Hong Kong and British Virgin Islands (2012)



Note: The figures are based on the geographic origin of FDI stocks reported by the respective host countries.

Source: Based on the data provided at. http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics-Bilateral.aspx

The fact that what are seen as foreign invested enterprises (FIEs) are actually domestic companies including state-owned companies can be seen from the observations of U.S.-China Economic and Security Review Commission which said that

> To be established as an FIE, 25% of invested funds must come from overseas. For many years, Chinese firms, including SOEs at all levels, diverted investment through shell companies in Hong Kong in order to register as an FIE. Domestic firms did so in order to take advantage of preferential tax rates and coveted import-export licenses. While the government changed the law in 2008 to eliminate this loophole, any firm already registered in this manner received a grandfathered exemption from the new law. These "fake FIEs" are significant and therefore skew any measure of state ownership that separately categorizes foreign invested companies and does not trace ultimate ownership.[13]

The cross-flow of funds between China, Hong Kong and tax havens can be seen from the following. Out of the 1,548 listed companies on the Main Board of the Hong

13 Andrew Szamosszegi and Cole Kyle, An Analysis of State-owned Enterprises and State Capitalism in China, U.S.-China Economic and Security Review Commission, October 2011, p. 12. http://www.uscc.gov/sites/default/files/Research/10_26_11_CapitalTradeSOEStudy.pdf

Kong stock exchange (HKEX) at the end of 2014, as many as 803 (52%) were identified by HKEX as Mainland enterprises.[14] Their year-end market capitalisation constituted 60% of the total market capitalisation of the Main Board. Interestingly, most of the HKEX companies are incorporated in countries other than Hong Kong and Mainland China. (Table-11) Though the number of companies given in the HKEX *Fact Book* for the year 2014 is a little larger than the 1,548 total number of companies listed on the Main Board of HKEX, the distribution is obvious. As many as 891 of the 1,753 companies were incorporated in Cayman Islands. Another 508 belonged to Bermuda. The number of those registered in Hong Kong and Mainland China are almost equal: 211 and 202 respectively. The funds raised on HKEX would consist of portfolio investments but would be treated as FDI when the listed companies invest back in China. Had such portfolio investors invested directly in Chinese stock exchanges the same would have been treated as portfolio investment.

Table-11: Distribution of Companies Listed on HKEX Main Board according to their Place of Incorporation (at the end of 2014)

Country	*No. Of Companies*
Cayman Islands	801
Bermuda	508
Hong Kong	211
Mainland China	202
Singapore	7
British Virgin Islands	6
England	4
Canada	4
Jersey	3
Luxembourg	2
Japan	2
Italy	1
USA	1
Brazil	1
Grand Total	**1,753**
Of the above:	
Companies listed prior to 1990	150
1990-1999	407
2000 & after	1,130

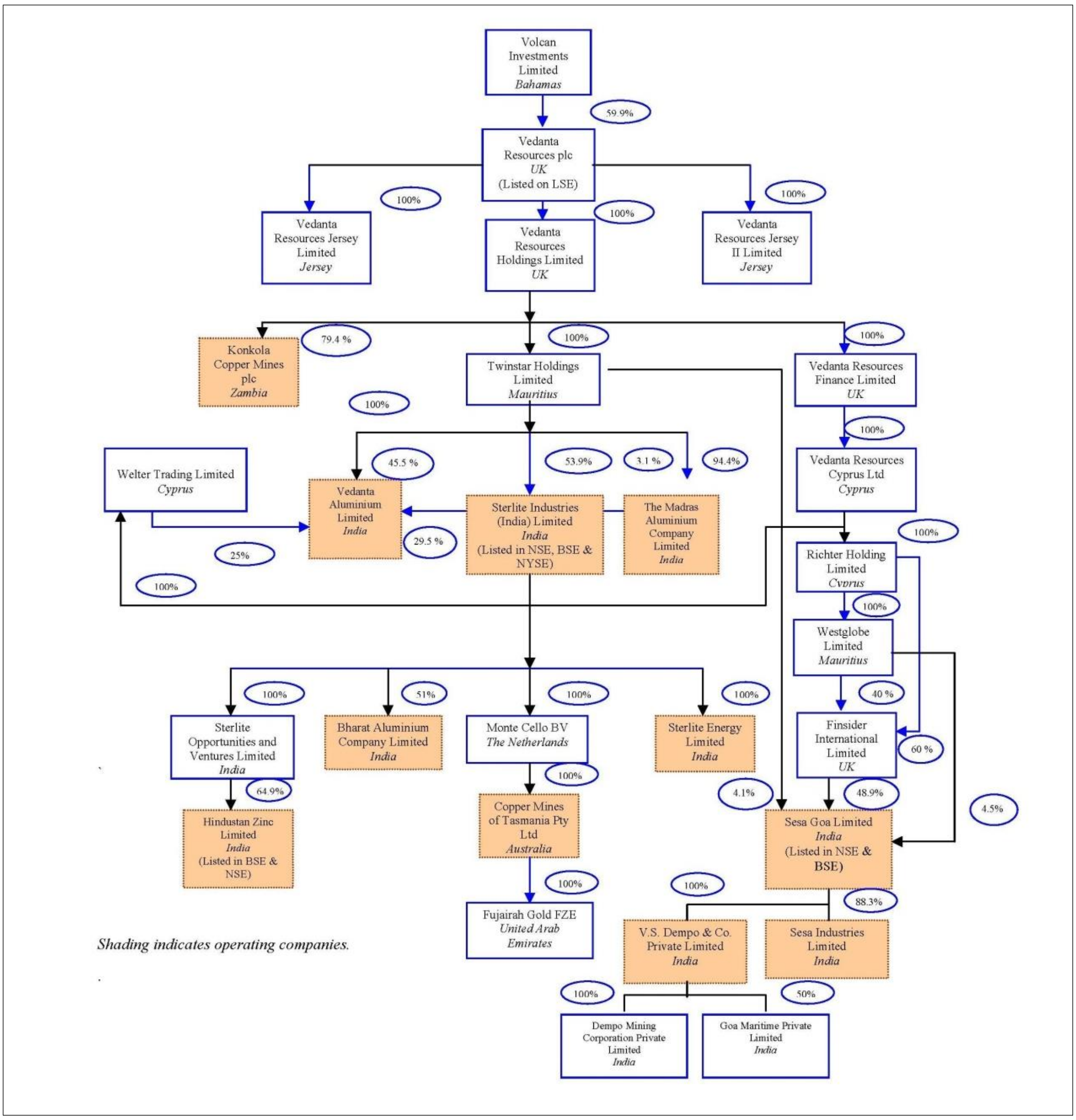
Date of listing is not available for 66 companies.

There are parallels in case of India too. Some companies promoted by Indians raise money on the London Stock Exchange (LSE) and then invest in India generally through Mauritius. Such investments are being treated as FDI. A prime example in this regard is investments by the Vedanta group, the main holding company of which

[14] Out of the 803, 179 companies were incorporated in Mainland China which are either controlled by Mainland Government entities or individuals. These are referred to as H-Share companies. 128 are termed as red-chip companies which are incorporated outside of Mainland China but are controlled by Mainland Government entities. 496 are referred to as Mainland private enterprises are neither H-Share nor Red-Chip companies. For details see: https://www.hkex.com.hk/eng/stat/statrpt/factbook/factbook2014/Documents/FB_2014.pdf

is incorporated in the Bahamas. (Diagram-2) From the list of non-promoter shareholders given in Table-12 it becomes obvious that investments raised from foreign portfolio investors abroad get transformed into FDI when they are invested back by the national entrepreneurs while investments by such financial investors on domestic stock exchanges would be treated as portfolio investments.

Diagram-2: Vedanta Group Structure (2010)



The structure is reported to have changed since. According to the Annual Report for FY 2015 of Vedanta Resources Plc., it still has ten subsidiaries in Mauritius including Twin Star Holdings Ltd.

Table-12: Top Shareholders of Vedanta Resources PLC and China Railway Group Ltd

Vedanta Resources PLC		*China Railway Group Ltd*	
Name of the Shareholder	*Share (%)*	*Name of the Shareholder*	*Share (%)*
Promoters	69.7	The China Railway Engineering Corporation (CRECG), State-owned	56.1
Standard Life Investments Ltd.	8.99	HKSCC Nominees Ltd (H Shares held on behalf of its various clients)	19.4
BlackRock Investment Management (UK) Ltd.	4.11	No. 3 Transfer Account of National Council for Social Security Fund	2.2
Majedie Asset Management Ltd.	1.88	Hong Kong Securities Clearing Co Ltd (A shares held on behalf of its various Southbound Investors of the co)	0.2
Legal & General Investment Management Ltd.	1.01	CSOP Asset Management Limited – CSOP FTSE China A50 ETF	0.2
TD Direct Investing (Europe) Ltd.	0.76	Bank of China – Harvest SSE-SZSE 300 Tradable Open-ended Index Securities Investment Fund	0.2
Barclays Bank Plc (Private Baking Singapore)	0.72	Industrial and Commercial Bank of China Co., Ltd – Huatai Bairui SSE-SZSW 300 Tradable Open-ended Index Securities Investment Fund	0.1
HSBC Global Asset Management (UK) Ltd.	0.42	Bill & Melinda Gates Foundation Trust	0.1
Barclays Bank Plc (Private Banking)	0.39	Industrial and Commercial Bank of China – Invesco Great Wall Selected Blue Chip Equity Securities Investment Fund	0.1
Hargreaves Lansdown Stockbrokers Ltd.	0.37	Abu Dhabi Investment Authority	0.1

Source: (i) http://www.4-traders.com/VEDANTA-RESOURCES-PLC-9590206/company/ accessed on October 13, 2015. and (ii) http://www.mzcan.com/china/601390/financial/15/EN/Annual%20Report%202014_35l1eaebjdRm.pdf

China vs. India

Further, a comparison of aggregate FDI flows into India and China and the investments involved in Greenfield projects and M&As, reveals an interesting phenomenon. From Table-13 it can be seen that during the nine years 2003 to 2012, China's FDI inflows were almost 4 times that of India. When in the case of Greenfield investments the ratio falls to just 2.2. In case of M&As the ratio is much smaller at 1.5. On the other hand, the last mentioned ratio suggests that China could be selling more of its enterprises compared to India. Was it really the case or the reality is different from what the aggregates seem to convey? An examination of the M&A deals each valued at $ 1bn. and above made during 2009-2014 reveals some interesting facts which also throw more light on the ground level realities. According to UNCTAD, there were 17 deals involving sale of Chinese companies and another 11 involving sale of Indian companies. (Table-14) The nationality of the companies is based on the location of ultimate parent company. It is pertinent to note that out of the 17 cases, in as many as eight, the ultimate acquirer is also a Chinese entity. In some, the ultimate parent of acquirer and the acquired is the same *i.e*, the M&A deals were nothing but intra-group transactions. One such deal is so large that it accounted for more than half of the deal values involving Chinese companies! Obviously, a majority of the amount was on account of exchange of shares between Chinese-controlled companies themselves. In four others, the ultimate parent belonged to Hong Kong. In three cases, the acquirers are financial investors who took minority stakes. This could be more in the form of providing finance to the enterprise rather than displacing the existing management. In one case however, Nestle acquired 60% stake in a Chinese enterprise and in another it is understood that the acquirer is a US PE investor (Carlyle). The present ownership status of this Chinese company which was once listed on NASDAQ is not known.

Table-13: China vs. India in Global FDI Flows (2003-2011)

Investment	*World Total FDI Inflows ($ mn.)*	*Share of China (%)*	*Share of India (%)*	*Ratio of Investment into China and India*
FDI Inflows	*11,572,854*	6.78	1.71	3.96
Value of Cross-border Greenfield Investments	*8,808,568*	12.10	5.41	2.24
Value of Cross-border M&As	*4,346,578*	1.62	1.05	1.54

Based on UNCTAD data.

Table-14: Cross-border M&A deals relating to China and India Worth over $1 billion completed during 2009-2014

	Year	*Acquired Company, Host Economy*	*Ultimate Acquired Company and Ultimate Host Economy*	*Acquiring Company and Home Economy*	*Ultimate Acquiring Co and Ultimate Home Economy*	*Industry of the ultimate acquiring company*	*Value ($ billion)*	*Shares acquired (%)*
	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*
		China						
1	2010	Album Resources Pte Ltd, Australia	China Minmetals Corp, China	All Glorious Ltd, Australia	China Minmetals Corp, China	Primary nonferrous metals, except copper, aluminum	2.8	100
2	2013	Chalco Iron Ore Holding Ltd, Hong Kong, China	Aluminum Corp of China Ltd, China	Aluminum Corp of China Overseas Holdings Ltd, Hong Kong, China	Aluminum Corp of China, China	Primary production of aluminum	2.5	65
3	2013	91 Wireless Websoft Ltd, China	NetDragon Websoft Inc, China	Baidu (Hong Kong) Ltd, Hong Kong, China	Baidu Inc, China	Information retrieval services	1.8	100
4	2014	CITIC Ltd, China	CITIC Group Corp, China	CITIC Pacific Ltd, Hong Kong, China	CITIC Group Corp, China	Investors, nec	42.2	100
5	2010	Tianjin Port Co Ltd, China	Tianjin Port (Group) Co Ltd, China	Grand Point Investment Ltd, Hong Kong, China	Tianjin Municipal Tanggu, China	City agency	1.5	57
6	2014	Noble Agri Ltd, Hong Kong, China	COFCO Corp, China	Investor Group, China	Investor Group, China	Investors, nec	4.0	51
7	2014	Phoenix Energy Holdings Ltd, Canada	CNPC, China	Phoenix Energy Holdings Ltd, Canada	CNPC, China	Crude petroleum and natural gas	1.1	40
8	2013	Eureka Investment Co Ltd-Asset, China	Peoples Republic of China, China	Tonic Industries Holdings Ltd, Hong Kong, China	Peoples Republic of China, China	National government	1.1	100
9	2013	Yashili International Holdings Ltd, China	Zhang International Investment, China	China Mengniu International Co Ltd, China	China Mengniu Dairy Co Ltd, Hong Kong, China	Dry, condensed, and evaporated dairy products	1.4	90
10	2012	Unicom New Horizon Tele-communications Co Ltd, China	China United Network, China	China United Network Communications Corp, China	China Unicom(HK)Ltd, Hong Kong, China	Telephone communications, except radiotelephone	2.0	100

	Year	Acquired Company, Host Economy	Ultimate Acquired Company and Ultimate Host Economy	Acquiring Company and Home Economy	Ultimate Acquiring Co and Ultimate Home Economy	Industry of the ultimate acquiring company	Value ($ billion)	Shares acquired (%)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
11	2009	GCL Solar Energy Technology Holdings Inc, China	Happy Genius Holdings Ltd, China	GCL-Poly Energy Holdings Ltd, Hong Kong, China	GCL-Poly Energy Holdings Ltd, Hong Kong, China	Cogeneration, alternative energy sources	3.8	100
12	2014	China Merchants Securities Co Ltd, China	China Merchants Securities Co, China	Shenzhen Zhaorong Investment Holding Co Ltd, China	China Merchants Group Ltd, Hong Kong, China	Marine cargo handling	1.3	14
13	2011	China	China	Russian Federation	Russian Federation	Investors, nec	1.5	15
14	2011	Hsu Fu Chi Intl Ltd, China	Hsu Fu Chi Intl Ltd China	Nestle SA, Switzerland	Nestle SA, Switzerland	Chocolate & cocoa products	1.7	60
15	2013	Ping An Insurance (Group) Co of China Ltd, China	Ping An Insurance (Group) Co, China	Investor Group, Thailand	Investor Group, Thailand	Investors, nec	9.4	16
16	2013	Focus Media Holding Ltd, China	Focus Media Holding Ltd, China	Giovanna Acquisition Ltd, China	Giovanna Parent Ltd, United States	Investment offices, nec	3.6	100
17	2011	Taikang Life Insurance Co Ltd, China	Taikang Life Insurance Co Ltd, China	Investor Group, United States	Investor Group, United States	Investors, nec	1.2	16
						Total	82.9	
		India						
1	2011	InterGen, United States	GMR Holdings Pvt Ltd, India	China Huaneng Group, China	China Huaneng Group, China	Electric services	1.2	50
2	2014	Videocon Mozambique Rovuma 1 Ltd, Mozambique	Videocon Industries Ltd, India	Undisclosed Special Purpose Vehicle, India	Oil & Natural Gas Corp Ltd, India	Crude petroleum and natural gas	2.5	100
3	2010	JSW Steel Ltd, India	JSW Steel Ltd, India	JFE Steel Corp, Japan	JFE Holdings Inc, Japan	Steel works, blast furnaces, and rolling mills	1.0	15
4	2009	Tata Teleservices Ltd, India	Tata Sons Ltd, India	NTT DOCOMO, Japan	Nippon Telegraph & Telephone, Japan	Telephone communications, except radiotelephone	2.7	26
5	2011	Reliance Industries Ltd-21 Oil & Gas Blocks, India	Reliance Industries Ltd, India	BP PLC, United Kingdom	BP PLC, United Kingdom	Oil and gas field exploration services	9.0	30
6	2014	GlaxoSmithKline Pharmaceuticals Ltd, India	GlaxoSmithKline Pharmaceutical, India	GlaxoSmithKline Pte Ltd, Singapore	GlaxoSmithKline PLC, United Kingdom	Pharmaceutical preparations	1.0	24
7	2014	United Spirits Ltd, India	United Spirits Ltd, India	Relay BV, Netherlands	Diageo PLC, United Kingdom	Malt beverages	1.9	26
8	2013	United Spirits Ltd, India	United Spirits Ltd, India	Relay BV, Netherlands	Diageo PLC, United Kingdom	Malt beverages	1.0	27
9	2013	Hindustan Unilever Ltd, India	Hindustan Unilever Ltd, India	Unilever PLC, United Kingdom	Unilever PLC, United Kingdom	Food preparations, nec	3.6	15
10	2010	Piramal Healthcare Ltd , India	Piramal Healthcare Ltd, India	Abbott Laboratories, United States	Abbott Laboratories, United States	Pharmaceutical preparations	3.7	100
11	2013	Agila Specialties Pvt Ltd, India	Strides Arcolab Ltd, India	Mylan Inc, United States	Mylan Inc, United States	Pharmaceutical preparations	1.9	100
						Total	29.5	

Note: As long as the ultimate host economy is different from the ultimate home economy, M&A deals that were undertaken within the same economy are still considered cross-border M&As.

Source: UNCTAD, Web table 17, accessed at http://unctad.org/Sections/dite_dir/docs/WIR2015/WIR15_tab17.xls

Out of the 11 deals involving Indian companies, only one could be said to be between two ultimate parent companies belonging to India. In another, JFE Steel of Japan put in additional funds which formed 15% of the expanded equity capital of JSW Steel. The existing promoters of this listed company hold 40.4% shares. The Japanese company has a nominee and the filings with the stock exchange show JFE steel as a 'non-promoter'. Two other interesting deals in case of India are that of GlaxoSmithKline Pharmaceuticals India and Hindustan Unilever, both listed on the Indian stock exchanges. In both cases the foreign parents increased their stake by buying out some of the existing non-promoter shareholders. Far from a change in management, the investments resulted in enhanced control of the foreign parents in the respective companies. In case of the former the share increased from 50.7% to 75.0% and in the case of the latter the increase was from 52.5% to 67.2%. In fact, Unilever wanted to raise the stake to the maximum permissible level or 75% under the listing guidelines. Piramal Healthcare, United Spirits and Agila Healthcare are clear cases of change of control of the businesses from Indians to foreign companies. In case of Piramal Healthcare, however, India's official data on inflows does not show it as an acquisition. Interestingly, UNCTAD's data shows the indirect takeover of India's Huchison Essar by Vodafone as a transaction between Hutchison Whampoa, Hong Kong and Vodafone, United Kingdom. These M&A cases of China and India illustrate the nuances in the reported M&A transactions ignoring which one is likely to draw wrong inferences.

The problems in collecting and aggregating data at the international level can be gauged from the number of foreign affiliates reported by the International Trade Centre (ITC) for India. (Table-15) While www.investmentmap.org reports the number of foreign affiliates in India to be 4,633, the Annual Census of Foreign Liabilities and Assets conducted by the Reserve Bank of India (RBI) reports the number to be 13,686, more than three times the number of affiliates reported by ITC. This is in spite of the fact that ITC is seen to be counting regional offices located in different cities also as affiliates. One can see a similar underestimate in case of outward FDI.

Table-15: Number of Foreign Affiliates in India reported by ITC are much Smaller than RBI's Figures

Type of Affiliation	*RBI: Census of Foreign Liabilities & Assets*		*Foreign Affiliates according to UNCTAD*
	2012-13	*2013-14*	
No. of Cos. Reporting Inward Direct Invt (A+B+C)	**11,579**	**13,686**	**4,633**
A. No. of Subsidiaries	7,528	9,081	
Of which Listed Cos.	111	119	
B. No. of Associates	3,900	4,446	
Of which Listed Cos.	234	254	
C. Others	151	159	
No. Of Cos. Reporting Outward FDI	**~2,260**	**2,736**	**1,288**
No. Of Subsidiaries	NA	2,012	

The sole purpose of this long narrative is to underline the need for caution while interpreting international FDI flows and allied statistics. The need for disaggregated data is obvious. Even though efforts are being made at the global level, it would be quite a long time uniformity is achieved across most of the reporting countries. Devoid of the developmental content, the aggregates as they are presented now could serve the purpose of infusing competition among developing countries for attracting larger volumes of FDI. India should take a much closer look at its inflows and assess how far they are serving its needs and where the gaps lie. Apart from looking at its own data, India could benefit from monitoring the behaviour of large multinational corporations in terms of the markets they are serving and the markets into which they are expanding, especially through greenfield investments. In sum, India has to rely on its own analytical inputs. Efforts to attract FDI should be guided more by the felt sectoral needs rather than on generic FDI flows. Even the OECD suggested that countries may generate data on round-tripping, SPVs, M&As, etc.[15]

[15] OECD, *Benchmark Definition of Foreign Direct Investment*, 4th Edition, 2008.s