DETERMINANTS OF FOREIGN ACQUISITIONS: THE CASE OF INDIAN STEEL SECTOR

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ABSTRACT
This study analyses the determinants for foreign direct investment outflows from the Indian steel manufacturing companies, using the theoretical framework of eclectic paradigm as developed by Dunning. The results suggest that asset-seeking is the dominant motive for Indian steel companies for making foreign investments, followed by resource-seeking. The government policy does not play any prominent role, at least for the steel sector.

Key words: FDI outflows, Indian steel sector, eclectic paradigm, asset-seeking, resource-seeking

1. INTRODUCTION
Since the beginning of economic reforms in 1991, Indian markets became open to foreign direct investments (FDI), both inward and outward. United Nations Conference on Trade and Development's (UNCTAD) World Investment Report 2006 (WIR06) recorded the new trend of increasing FDI outflows from developing and transition economies. In the year 2007, the FDI outflows from India suddenly shot up to USD 13.649 billion. Sathye (2008) suggests that rather than following a smooth ‘development path’ as a nation, Indian FDI outflows exhibit a rather uneven and sporadic pattern. The reason for this pattern can be attributed to the firm-specific advantages and individual decisions of the firms, as the Indian government’s policies and incentives for encouraging domestic firms for cross-border acquisitions are not as rigorous as that of neighbouring China. The majority of the 2007 FDI outflows were attributed mainly to the two acquisitions made by the private sector companies, Tata Steel and Hindalco which operate in the metal sector. This paper investigates the motives for cross-border acquisitions by the Indian steel sector.

1.1 Indian Steel Sector
After the Independence in 1947, India adopted mixed economy where the public and private sectors co-existed. However, the government policy was more inclined towards socialism and with government’s protection and mainly the loss-bearing capacity and capital-pouring capacity, many of the capital-intensive large companies happened to be in the public sector. Iron and steel sector was not an exception. In 1947, only three steel manufacturing companies existed in India, Tata Iron & Steel Company (TISCO), the public sector Indian Iron & Steel Company (IISCO) and the Visvesvaraya Iron and Steel. Today, the largest firm in the public sector is the Steel Authority of India Limited (SAIL) with the Government of India (GOI) being the largest shareholder with about 86% shareholding. The company’s remaining capital was sold to the market after the reforms began in 1991. As per the 2007-08 annual report of the Ministry of Steel, GOI, India was the fifth largest producer of crude steel in the year 2006, however, its per capita consumption was only 46 kg as compared to 400 kg in the developed countries. The production of crude steel has grown steadily over the years, from 34.707 million tonnes in 2002-03 to 50.817 million tonnes in the year 2006-07. Rashtriya Ispat Nigam Limited (RINL) is another large public sector undertaking (PSU) in the Indian steel sector. There were a number of mergers and acquisitions by SAIL in the recent years, but they were all within the country.
Currently, the private sector companies play a dominant role in steel production in India. The main players are Tata Steel, Essar Steel, JSW Steel, Jindal Steel & Power Ltd (JSPL), Ispat Industries Ltd (IIL), Bhushan Power &Steel Ltd (BPSL) and Monnet Ispat & Energy Ltd (MIEL). The private sector took full advantage of the opportunities that became available with the economic reforms since 1991 – especially the ending of ‘licence raj’ and gradual elimination of restrictions on imports and exports in most of the sectors. For example, the $12 billion acquisition of overseas Corus Ltd made Tata Steel the fifth largest steel producer in the world, (Ministry of Steel, GOI, annual report 07-08). Another factor in favour of the private sector was the increase in global demand for steel. With the changing scenario, many of the public and private sector steel companies are now investing increasingly in research & development (R&D) activities which were previously restricted only to SAIL and Tata Steel. The R&D efforts are mainly directed towards better technology and increased efficiency to reduce costs and improve the quality of the product, energy conservation, environment-friendly systems, new product development etc, (Ministry of Steel, GOI, annual report 07-08).

Even though SAIL is trying to improve technology and increase production, it is the private sector companies that have invested overseas for various reasons. The current study tries to determine the motives behind these acquisitions using the eclectic paradigm framework as developed by Dunning (1981, 1998).

2. LITERATURE REVIEW

Dunning has done a fundamental work in analysing the economic development of a country and its foreign investments – both inward and outward- through numerous research studies over forty years. Most of the studies that attempt to explain FDI inflows and outflows of various countries and regions, have used the eclectic paradigm framework as developed by Dunning (1981). Dunning explains five stages a country passes through during its journey from the early development to the fully developed status. These stages are marked by different proportions of foreign investment inflows and outflows. Apart from this, Dunning (1981, 1998) suggests various motives for a firm’s foreign investments such as strategic-asset seeking, market-seeking, efficiency seeking etc.

Prior research has tried to analyse motivation for the growth in the outward FDI of various countries. Deng (2004) investigated the motivation for outward investments by the Chinese firms. This study identifies five motives for Chinese investments namely, resource-seeking, technology-seeking, market-seeking, diversification-seeking and asset-seeking. Some special characteristics of the Chinese firms making outward investment as noted by Deng
include the monopolistic position of the investing firms in the domestic markets and the state-ownership. Chinese government policy plays a great role in boosting foreign investments. Of the large firms making outward investments, only one is privately owned and 25 are government-owned (Deng 2004). This situation is different from their Indian counter-part. Aggarwal and Agmon (1990) developed a model which indicates that in the process of internationalisation of firms based in developing countries, the government’s role is important only in the initial stages after which firm-specific factors play a dominant role. However, this model has not been empirically tested.

In his study of Chinese outward FDI, Zhan (1995) suggests market-seeking as an important motive as there is excess production capacity available in the manufacturing sector for textile and clothing, bicycles, footwear and electric appliances. Another dominant motive as identified by this study is the resource-seeking motive as the per capita availability of natural resources is relatively low in China. Efficiency-seeking is not a dominant motive as China has abundant supply of low-cost labour.

In yet another study about the determinants of Chinese outward FDI during 1984-2001, Buckley et al (2007) found three factors having significant impact on outward FDI, namely the host-country market size, cultural proximity and policy liberalisation. Asset-seeking and resource-seeking were not found to be significant determinants of the outward FDI.

Wang and Wong (2007) examined the effect of business cycle fluctuations on FDI outflows. The results suggest that these fluctuations would have more negative impact on FDI outflows when the general economic conditions are not good.

Antaloczy and Elteto (2002) investigated the motives for the Hungarian firms to invest in CEE countries. The results of this study suggest that market-seeking is the most important motive for the outward investments by Hungarian firms, followed by strategic asset-seeking.

Mazerolle (2006) compared the effect of enlargement or addition of provinces or countries in two regions – the Pan Pearl River Delta Region (Pan-PRD) and EU 25, in attracting foreign investment. The results revealed that the addition of 8 provinces to the Pan-PRD region attracted about 1% of total world FDI stocks, whereas the addition of 10 countries to the EU helped to attract 2.7% of the world FDI stocks. This difference was attributed to the cultural and geographical ties between the CEE and west European countries which helped to attract the FDI.

On the other hand, Graham et al (2008) examined the motives for UK firms to invest in less developed countries. The results suggest that the firms with high liquidity but rather low growth rate are more likely to invest in emerging markets.

Kyrkilis and Pantelidis (2003) investigated the relationship between outward FDI and certain macro-level factors such as income, exchange rate, technology, human capital and openness of economy using the data from five European Union (EU) and four non-EU countries during the period 1977-1997. The results suggested country-wise differences, and also differences between the developed and developing countries. However, generally speaking, a significant positive relationship between real GNP and FDI outflows was found, whereas exchange rate showed a significant negative relationship.

Instead of focusing on a country, Kreitl and Oberndorfer (2004) surveyed 100 top European engineering consulting firms to investigate the motives behind mergers and acquisitions. The dominant motives as suggested by the findings were diversification and market-seeking. To a lesser extent, increase in firm’s market share was another motive. However, tax reasons and excess liquidity with the firms were not important while making acquisition decisions.

3. THEORETICAL FRAMEWORK AND RESEARCH DESIGN

Dunning (1981, 1998) has identified certain motivating factors for the firms investing in foreign countries such as resource seeking, market seeking, efficiency seeking (for example cutting costs by availing cheap labour), etc. India with its vast population has abundant supply of
labour at a reasonable cost, hence this study considers only two motives namely resource seeking and market seeking for the steel sector companies investing overseas. Following Deng (2004) and Buckley et al (2007), investments in production facilities situated in less developed countries is a proxy for market seeking, and the investments made in production facilities in developed countries are a proxy for asset seeking. Investments made for acquiring relevant resources are a proxy for resource seeking. The deal amount is not available in most of the cases.

### FOREIGN ACQUISITIONS BY INDIAN STEEL COMPANIES

<table>
<thead>
<tr>
<th>Year</th>
<th>Acquisition</th>
<th>Motive</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>Nat Steel Asia, Singapore</td>
<td>Asset seeking</td>
</tr>
<tr>
<td>2006</td>
<td>Millenium Steel, Thailand</td>
<td>Market seeking</td>
</tr>
<tr>
<td>2007</td>
<td>Corus, UK</td>
<td>Asset seeking</td>
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<td></td>
<td>Essar Group</td>
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<tr>
<td>2007</td>
<td>Minnesota Steel</td>
<td>Resource seeking</td>
</tr>
<tr>
<td>2007</td>
<td>Algoma Steel</td>
<td>Asset seeking</td>
</tr>
<tr>
<td>2005</td>
<td>Euro coke energy</td>
<td>Resource seeking</td>
</tr>
<tr>
<td>2005</td>
<td>Euro Ikon Iron and Steel</td>
<td>Asset seeking</td>
</tr>
<tr>
<td>2007</td>
<td>Jindal Enterprises LLC</td>
<td>Asset seeking</td>
</tr>
<tr>
<td>2007</td>
<td>Saw Pipes USA</td>
<td>Asset seeking</td>
</tr>
<tr>
<td>2007</td>
<td>Jindal United Steel Corp</td>
<td>Asset seeking</td>
</tr>
<tr>
<td>2006</td>
<td>Mine in Bolivia</td>
<td>Resource seeking</td>
</tr>
<tr>
<td>2005</td>
<td>Manufacturing facility in Bulgaria</td>
<td>Market seeking</td>
</tr>
<tr>
<td>2006</td>
<td>Coal mines in Colombia</td>
<td>Resource seeking</td>
</tr>
<tr>
<td>2007</td>
<td>Mine in Montenegro</td>
<td>Resource seeking</td>
</tr>
</tbody>
</table>

Source: compiled from company websites and news items

### 4. DISCUSSION OF RESULTS

The above analysis suggests that for the overseas acquisitions by Indian steel sector companies, ‘asset seeking’ is the motive in 50% cases. In 36% cases ‘resource seeking’ is the motive and for the remaining 14% deals, ‘market seeking’ is the motive. Of these deals, the largest deal so far in the Indian corporate history is that of Tata Steel – Corus (UK) for USD 12 billion. This deal underlines the asset-seeking intention of the Indian steel sector companies.

All the above firms are operating in private sector and not a single public sector steel company has gone for foreign acquisition. This emphasises the relevance of firm-specific advantages of the individual firms, rather than an incentive in the form of favourable government policy as in case of China.

### 5. CONCLUSION

In case of the foreign acquisitions made by Indian steel companies, asset-seeking is a dominant motive. These acquisitions seem to have resulted from firm-specific advantages rather than government efforts in the form of encouraging policy.

### AUTHOR PROFILE

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References


