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Foreign Direct Investment and Strategic Partnerships: Cross Border Acquisitions between India and Africa

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Abstract

The African economy provides an investment opportunity for International players both in terms of procuring natural resources and opening up a potential one billion consumer market. Along with the vast investment potential, on the downside firms face challenges that come from investing into nations with corporate governance, infrastructure and regulatory environments that are not as conducive for investments as found in developed nations. In this paper, we study Foreign Direct Investments (FDI) in the form of cross border acquisitions made by Indian firms in Africa during the 2002 to 2010 time frame. We report on the growth of Indian investments into Africa, nature of investments during this period and short time cumulative abnormal returns (CARs). We select two large deals that were subsequently withdrawn, to understand the nature of issues that come up while Indian firms invest in Africa. The paper's findings provide possible avenues of partnerships through investment in Africa and the challenges associated with the same.

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Keywords: Africa; Foreign Direct Investments; Cross Border Acquisitions

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1. Introduction

While economic growth has been slowing down around the globe, the outlook for African economies is very positive and expected to outpace the growth of other economies (Ernst & Young, 2013). Reflecting the growing importance of Africa as an investment destination, the value of Foreign Direct Investments (FDI) into Africa has grown from an annual figure of $ 9 billion in 2000 to $ 50 billion in 2012 (UNCTAD, 2013). Traditionally investments into Africa have been in the extractive mining, quarrying and petroleum sector. In the recent years there has also been a growing awareness of Africa's potential 1 Billion consumer market and a positive demographic balance with about 60% of the population below 25, resulting in a growing interest in consumer related and infrastructure sectors such as financial services, food beverage, motor vehicle, telecommunication etc. In their annual attractiveness survey on Africa in 2013, Ernst & Young report that firms that have already established a business presence in Africa are very positive on further investments into Africa, and have ranked Africa as the second most attractive destination for investments, after Asia. Emerging market firms have been showing a rising interest in investing in Africa. With firms from Malaysia, China and India being the largest emerging market investors into Africa in 2012.

In recent years, Indian investment in other developing countries has become a major component of South-South co-operation. The development indicators have motivated Indian firms to invest in Africa through a growing number of Greenfield projects and cross border deals and helped in fostering development partnership between the two nations. African economy provides an investment opportunity for International players both in terms of procuring natural resources and opening up a potential 1 billion consumer market. African markets provide substantial growth prospects for firms investing into Africa, however they also face challenges that come from investing into a country with different corporate governance and regulatory environment. For example, the Bharti MTNL deal could not be carried out due to regulatory hurdles.

In this paper, we study outward FDI in the form of cross border acquisitions made by Indian firms in Africa during the 2000 to 2010 time frame. We report on the nature of investments during this period. We report the 3 day and 11 day cumulative abnormal returns (CARs) using the event study methodology. We also use a case study approach to analyze the reasons behind two deals above $ 1 Billion that were withdrawn to understand the hurdles which lead to the deal withdrawal, to gain insights for further south-south co-operation with Africa.

2. Literature Review

We draw on literature on outward investments by developing market firms and also on investments into developing market firms. Sethi D, Guisinger, Phelan, Berg (2003) study trends in FDI into different regions and report that developing countries such as Asia and Africa followed a very restrictive policy and almost hostile stance towards inward investments in the 1980s, which prevented significant FDI inflows into these countries. Governments from these countries gradually opened up these economies during 1991-97 which lead to a growth of investments into these countries after this liberalization period. Panagiotis, Liargovas and Skandalis (2012) find a direct positive causality between trade openness and inflows of FDI in developing economies including Africa. Following opening up of African economies FDI into Africa has grown from an annual figure of $ 9 billion in 2000 to $ 50 billion in 2012.

Yiu, Lau and Bruton (2007), Elango and Patnaik (2007), Filatotchev, Strange, Piesse, Lien 2007, Hoskisson, Eden, Lau and Wright (2007) study outward investments by developing countries and argue that the strategy followed by these nations is not the same as that followed by developed countries and are more aggressive in their expansion strategy . They have expressed a need for theory development on outward investment strategy of developing nations. Pradhan, Abraham (2005_ examine the patterns and motivations behind cross border acquisitions by Indian firms during 1999 to 2001, which was soon after the liberalization of inward investment policy by developing nations. At that time they report that Indian investments at that time were directed largely towards developed nations. In a more recent study Gubbi S, Aulakh P, Ray S, Sarkar M, Chittoor R. 2010 argue that Indian firms were forced to expand internationally to survive in an increasingly competitive home environment. Like Pradhan & Abraham (2005), Gubbi et al(2010) also find that during their period of study from 2000 to 2007 a majority of investments by Indian firms were directed towards developed countries of Europe and North America. However, there has been a growth in south-south investments too. For examples firms from Malaysia, China and India were the largest emerging market investors into Africa in 2012. In this paper we explore outbound FDI in the