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COMPARATIVE ANALYSIS OF FDI IN CHINA AND INDIA

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Abstract

Some emerging markets have been leaders in the world and have grown at a higher rate benefiting from higher Foreign Direct Investments (FDI) by Trans National Corporations (TNCs) and some have been laggards and have not able to attract as much FDI and grow that efficiently. Why China gets 60 billion dollars FDI annually as compared to India that does not even get 6 billion dollars is an intriguing question? This dissertation explores the determinants of FDI in such emerging economies to answer the above question. What has India done till now to attract FDI? What has been China's strategy to become the most FDI attracting country in the world? What lessons India can learn from China and improve its FDI inflow? The study attempts to theorize what lessons emerging markets that are laggards in attracting FDI, such as India, can learn from leader countries in attracting FDI, such as China in the global economy.

This study fills the gap in the literature by analyzing the Indian data at the relevant micro state level for the period 1992-2005 and comparing it with the Chinese data for period of 1978-2005 at the relevant economic zone level. Indian FDI attraction model was tested using OLS and autoregressive models and it was found that India has grown due to its human capital, size of the market, rate of growth of the market, and political stability. For China, congenial business climate factors comprising of making structural changes, creating strategic infrastructure at SEZs, and taking strategic policy initiatives of providing economic freedom, opening up its economy, attracting diaspora, and creating flexible labor laws were identified as drivers for attracting FDI. The model using these variables was tested with OLS regression and autoregressive regression analysis and was found significant. There are lessons that India can learn from China. Emulating and replicating successful infrastructural stories such as DMRC, DVP, and Golden Quadrilateral will help develop infrastructure. Structural Shift in terms of moving idling labor in agriculture to 'skill-neutral mass manufacturing' will employ millions from 'seven-up' BIMAOR UT UP CHA JA (sick get up and conquer) states, instead of current trend of just developing the service sector core competence only. Few but large world class SEZ's in 'seven-up' states on the east coast will help leverage 'demographic-realities'. Privatizing oil sector and banks to reduce government intervention and provide economic freedom, opening economy to level playing field to TNCs by reduced tariff and taxes, proactively engaging diaspora, and flexible labor laws to permit free entry and exit to TNCs will help India attract higher FDI. This study might help countries such as PIN (Pakistan, Indonesia, and Nigeria) which, will follow the BRIC economies in growth, want to grow, to broaden their understanding and formulate policies to attract FDI. At the enterprise level, it might help TNCs in understanding markets and formulating entry and growth strategies in these markets.

Introduction

A simple definition of FDI would be –“An investor based in one country acquires an asset in another country with the intent to manage that asset” (OECD, 2000).

It is important to understand the significance of FDI in global trade and in economic development. Also it is important to understand the shift in FDI towards the developing world, and the future trends of FDI. The global stock of FDI at the end of 2006 stood at \$ 10 trillion which is equal to the current combined GDP of the four largest economies of the world after USA- Japan, China, Germany, and the United Kingdom. More than two-third of FDI is between TNC's. Total revenues for the Global 500 TNCs in 2006 add up to \$18.9 trillion, a third of the world's GDP. 70,000 TNCs and their 6, 90, 000 foreign affiliates, contributing \$19 trillion in sales, a third of world GDP, create major component of this FDI stock and worldwide FDI flows. GE (US), Vodafone (UK), and Ford (US) are the top three non-financial TNCs worldwide contributing maximum FDI flows. The global FDI in 2005 increased to \$730 billion registering a growth of 18% over \$648 billion of 2004. Of the total FDI flows, the developed world contributed \$637 billion, out of which half is from only three countries-US, UK, and Luxemburg. In 2005 the net outflows from the developed world exceeded the inflows by \$260 billion. For the US, the largest economy in the world with \$ 12.5 trillion GDP, FDI outflow increased by 90% to \$ 229 billion in 2005. The developing world FDI grew by 40% to \$ 233 billion in 2004 mainly due to M&A activity and also due to green field FDI rising consecutively for the third year. Studies suggest that FDI flows by TNC's have transformed international trade in the last two decades and created new giants and a new world order (Blonigen, 2005). For 2006-07, global FDI flows are expected to rise further if economic growth is consolidated and becomes widespread, corporate restructuring takes hold, profit growth persists and the pursuit of new markets continues (UNCTAD, 2005).

The success of Asian Tigers- 'South Korea, Hong Kong, Taiwan, and Singapore' in last two decades has been largely attributed to FDI (Zhang, 2001; Lall, 1993). Following the growth of Asian Tigers, countries are creating 'location tournaments' by giving various incentives to TNCs to attract FDI to their lands (Wheeler and Mody 1992). Globalization has created many opportunities for the emerging markets that were earlier unavailable to them. Talking of the potential of growth of emerging markets a Goldman Sachs study 'Dreaming with BRIC's: The Path to 2050' reports that Brazil, Russia, India, and China (BRIC) can be larger than the G8 in less than 40 years from now. AT Kearney's 'Global FDI Confidence Index' ranks China as number one country for the last three consecutive years in attracting foreign direct investment.

Research purpose and motivation

The purpose is to learn what strategies leaders in emerging market growth have adopted to attract FDI and evolve and what is lacking on part of the laggards. What laggards have done and what they have not done. The purpose is to develop a model for both categories and test the model empirically to substantiate the hypotheses. What are the lessons that laggards can learn from these leaders? The study intends to show a path to the PIN countries and other markets that will emerge in next two decades.

A search for the terms 'China and India' and 'Foreign Direct Investment' on Proquest online search for dissertations and peer reviewed academic journals returned only six entries. Of these only three are relevant. Of the three relevant dissertations, first discusses

the FDI from Chinese perspective and makes a passing reference to India, the second discusses the role of overseas Chinese investment, and the third discusses the ASEAN economies. There are not many studies from the Indian perspective. Anantaram (2004) research is one study, another study by Wei (2004) focuses on China. Kumar (1989) study leaves out the Indian reform period. Venkatachalam (2000) study does not compare India and China the way it has been done in this study. This study intends and attempts to fill these gaps in the literature.

Not enough studies exist on India from an Indian perspective. Apart from helping India lean from leader in FDI attraction this study builds and tests a probable model of growth for emerging markets. PIN (Pakistan, Indonesia, Nigeria) countries can learn from this experience and tailor make their economic plans to grow at a faster rate.

FDI impacts development in emerging markets:

There are many studies on benefits of FDI to the emerging markets. There is lack of sufficient internal capital in emerging markets as the governments are devoid of resources, the private sector does not have enough capital, and the country lacks the know-how to invest in relatively large projects. The savings in these markets are not enough to create intrinsic economic growth. Therefore, emerging markets need foreign capital for growth. FDI is one of the major sources of foreign capital for these countries [Seid (1988); Srinivasan (2002); Jenson (2003)]. Even Government of India (GOI Economic Survey, 2001-02) recognizes the importance of FDI in economic growth

Literature review:

Why firms engage in FDI? Hymer (1959) was the first one to explore this phenomenon in his doctoral dissertation and stated 'FDI as a means of transferring tangible and intangible assets to organize international production.' Market failure theory (Vernables, 2004) states that firms organize international production to avoid market failure that might arise from licensing to a third party. Inter-firm rivalry theory (Knickerbocker, 1973) states that firms invade each other's home market to fight and create an oligopolistic market. Vernon's Product Life-cycle theory states that as product and markets mature, firms move production overseas to appropriate balance rent from the declining phase in the product life cycle. Resource Based View (Wernerfelt, 1984) stresses on the fact that firms have specific resources that are unique and provide advantage to them and firms go to foreign markets to benefit from these advantageous resource positions. Dunning's Eclectic Paradigm theory (1996) of 'OLI'- Ownership, Location, and Internalization states three TNC motives or a combination of these motives to conduct foreign investment. Firms have ownership of specific advantages which they want to exploit in other markets, locations have specific advantage that TNC want to exploit, internalization is preferred by TNC over third party licensing to avoid 'spill-over'. Caves' Vertical vs. Horizontal FDI theory states that firms either undertake FDI to seek efficiency in their global supply value chain or make FDI to enter horizontally to explore new markets. Macroeconomic theories look at value maximization objective of

the firm as a motive for foreign investment. Modern theories mention complex form of structure and processes by TNCs by conducting foreign investment in an 'export platform' manner that allows TNC's to leverage and benefit from their global operations (Bergstrand and Eggar, 2004). In my view all FDI is 'endurance seeking' as TNC's have to survive in current competitive global scenario otherwise they will perish. Also, I think that FDI is not horizontal or vertical but linear as firms attain synergies through dual operations.

What are the determinants of FDI? Literature review suggests that market size (Lall et al, 2003), market growth rates (Jenson, 2003), political stability (Anantaram, 2004), corruption (Wei, 2003), exchange rate (Crowley and Lee, 2003), labor productivity (Ramamurti, 2004), economic freedom (Lee, 2005), infrastructure (Chantasawat, 2004), openness (Singh and Jun, 1995), human capital (Hsiao, 2001), and taxes affect FDI flows to global markets.

Why laggards are falling behind?

There are many factors that are restricting laggard's attractiveness as an FDI destination (Guha and Ray, 2000). Infrastructural bottlenecks have impacted FDI flows. History of invasion and rule by foreign trading company created a fear psychosis. Scant power availability has curtailed production, lack of manufacturing and stress on service sector growth has created a lopsided growth which is not commensurate with demographic realities. Bureaucracy and policy making has restricted FDI flows as the government's attitude has not been favorable for a considerable time (Bajpai and Sachs, 1999). Overdependence on agriculture and regional disparities between developed and backward states has created a 'bandwagon effect' and forced FDI only in certain areas, segments, and sectors of the economy. The 'super- six' states are getting most FDI (Anantaram, 2004). Services sector now contributes to 52% of GDP. Skill intensive manufacturing has reduced higher growth in the manufacturing sector. Despite starting much ahead of China, the SEZ movement in India has not picked (Srinivasan, 2003) up and is currently shrouded in controversies. The sea ports are underdeveloped and underutilized. FDI regime has been restrictive and not welcoming as is evident in higher tariffs and taxes on TNC's. The new FDI policy 2005 has not opened up many sectors to full participation by TNC's and policies are parochial. Fiscal deficits, subsidies, corruption has affected Real Gross Domestic Capital Formation (RGDCF). Lack of privatization, low exports, missing diaspora involvement, and archaic labor laws have prevented development of a conducive business climate.

Statistical Indian story thus far

Based on my research on FDI literature on determinants and factors, I developed the constructs and formed the hypotheses for emerging markets. I formulated six hypotheses. India is a typical example of an emerging market so I took India to investigate my propositions. Most Indian FDI has gone to six mega states of Maharashtra, Gujarat, Hyderabad, Andhra Pradesh, Tamil Nadu, and Delhi (Anantaram, 2004) and most of the

Indian growth is concentrated in the above six states (Kocher et al, 2006). My first construct included human capital in these states (Selected Educational Statistics, HRD Ministry, GOI-1992-2005). Other constructs that were measured at the national level were market size (GDP), market growth rate (GDP % growth), political stability (Interest rate), corruption (Transparency International Index, 1996-2005, trend extrapolated for 1992-2005), and exchange rate volatility (% change over last year). The Indian Model of FDI includes six above stated determinants and the impact of these variables in the model was tested to predict FDI inflows and changes. Data was analyzed for the period 1992-2005. FDI data was taken for the six states from 1992-2005 from Indian Planning Commission and www.indiastat.com and national Indian data was taken from World Development Indicators 2006 and www.euromonitor.Com

The impact of the six above stated independent variables was tested on FDI flows. Multiple Regression and Correlation (MRC) analysis was done to study the relationship. Pooled data was utilized for the study. Cross sectional data from states and time-series (panel data) for the period 1992-2005 was taken for the study. Above stated measures were tested in OLS & Autoregressive models. Heteroskedasticity was also tested. Model significance, correlation statistics (<0.7), and VIF statistics (<5.3) was checked and reported.

Overall the OLS model was found significant (90% confidence level, alpha equals 0.1, $F=49.82$, $p=0.000<0.1$, $\text{Adj. } R^2 = 74.12\%$). The autoregressive model was also found to be significant ($F=9.830$, $p=0.008<0.01$, $R^2 = 91.0$, $\text{Adj. } R^2 = 89.1$). The statistical analysis and findings of Indian FDI model suggests that FDI inflows in an emerging market of India in a globalize scenario are positively correlated with the human capital present in that market. Market size and the rate of growth were also found significant. These findings support the first three hypotheses. Political stability, corruption, and exchange rate volatility was also found to be partially significant lending support to the other three hypotheses.

Creating congenial business climate for attracting FDI

Congenial business climate in an emerging market leads to FDI. The purpose of FDI by TNC's is to 'seek endurance' in their global operations necessitated owing to the maturity of certain developed markets. Linear propagation of FDI in emerging markets offers a solution. The leader in attracting FDI in an emerging market creates congenial business climate in its economic market environment. Leader's Model of attractiveness has three underpinnings: structural changes, strategic infrastructure, and strategic policy initiatives.

Structural changes in the economy include improving physical infrastructure. Availability of road network, water, electricity, telecommunications, and other resources provides opportunity for TNC's to produce, move goods and services efficiently, and minimize costs to that they can compete globally on a cost advantage. This can be measured in total road length, per capita electricity/water consumption, number of telephone lines and mobile phone subscribers, etc.

Strategic infrastructure means location, content, and a strategic intent to organize economic activity in an emerging market. The infrastructure should be strategic to reflect on the existing demographic realities. It should be strategic to the extent that sectoral composition should complement demographic realities. Age, availability, and educational skill set of the labor force should be reflected in the strategic infrastructure. The strategic infrastructure should have connectivity with the hinterland to obtain continuous supply of cheap labor from backward areas. The specified area should be self contained and have world class infrastructure such as hotels, airports, banks, stock markets, retail stores, educational institutes, recreational facilities, etc. The infrastructure can be strategic if it has proximity to the largest global markets and has connectivity with the global shipping network. Such economic clusters are strategic in every sense of the system for merit term.

A strategic policy initiative implies policy initiatives to support the above stated strategic intent. My research indicates that these initiatives are fourfold in nature: creating economic freedom, facilitating openness, inviting diaspora involvement, and formulating flexible labor laws. Economic freedom can be provided by reducing government intervention in the economic activity, reducing fiscal burden by privatizing PSU's, cutting down subsidies, balancing development in different regions of the country. Openness in trade can be adopted by reducing tariffs, inviting TNC's to enter, invest, and exit or repatriate freely, reducing restrictions on trade, reducing bureaucracy and red-tape, and increasing exports. Diapora prowess of intellectual as well as economic capital can also be utilized for economic development. Their network relationship and TNC affiliations can be harnessed for emerging market growth. Flexible labor laws allow for free movement of labor and capital and increase efficiency in TNC operations. Policies directed towards attracting, retaining, and nurturing the quality talent promotes the system of merit.

China is an example of a country that has created this conducive business climate, attracted FDI over last twenty five years, and grown from \$163.6 billion economy to being a \$2.2 trillion dollar economy, the third largest economy in the world, and the fastest growing economy in the world. On purchase power parity basis, Chinese economy is the second largest economy of the world with \$9.412 trillion in 2005 just behind USA. China has been growing at the rate of 9.5% for last ten years. In 2006 china grew at the rate of 10%. At this rate China will double its economy in every eight years and in 2040 will be largest economy of the world surpassing the US. In 2006 FDI inflow to China was \$ 62.0 billion as opposed to \$6.0 billion for India. AT Kearney FDI Confidence Index 2006 ranked China the most attractive FDI destination ahead of the United States for the fourth consecutive year.

Testimony from leaders in the race: China- The more evolved emerging market:

China's achievements and comparison with India demonstrate the success of the congenial business climate adopted by China. In 1978 China (\$163.6 b) was behind India (\$168.0) in GDP. Chinese government initiated reforms in 1978 and carried them forward

in 1992. Deng Xio Peng, the father of Chinese reforms created an industrial revolution in a communist China. China followed an 'export-import' oriented growth pattern as opposed to an Indian 'import-substitution' pattern. Chinese government made structural changes in the economy, provided strategic infrastructure in form of SEZ's, and took strategic policy initiatives to provide freedom, openness in trade, attracted diaspora from Hong Kong to invest in Shenzhen and other neighboring areas, and made flexible labor laws to attract efficient labor in the manufacturing sector. All these factors attracted TNC's to set up manufacturing units in the SEZ's and export the produce to different parts of the globe. Modern China has an FDI stock of \$600 billion which contributes almost one-third of current Chinese GDP.

Structural changes made in the economy can be demonstrated through the development of Shanghai and its modern infrastructure. Shanghai was a backward small place some fifteen years back. The government initiated the change process that brought about significant improvements. Modern Shanghai attracts 180 million people, has a GDP of \$110 billion, has a life expectancy of 80 years, and has attained a growth rate of 10% for last ten years. Tallest Asian building Oriental Pearl Tower measuring 468 meters is located in Shanghai. Jingmao Mansion is the fourth largest building in the world. Shanghai World Financial Centre to be completed in 2009 might be the tallest building in the world. Shanghai has one of the most extensive bus system having 1000 lines. Shanghai Metro, subway, and elevated light rail have five lines which will increase to eight by 2010. Hongqiao and Pudong International airport attract the highest traffic in the world. Trans rapid train system is growing fast and Shanghai Maglev train system covers 30 kilometer trip in 7.21 minutes reaching a speed of 431 km/hour, highest in the world. Donghai Bridge is the longest cross-sea bridge in the world measuring 32.5 miles connecting Shanghai to the Yangshan islands.

Comparing Shanghai with India it seems strange that the achievements of the city are bigger than the country India. Shanghai received \$60 b in FDI as opposed to \$58 b for India. India's foreign trade was 30% less than Shanghai's \$241 b in 2005, Shanghai world's largest port handled 443 million tones cargo against 423 million tones handled by 12 ports of India. Coastal areas of Pearl River Delta, Yangzi River Delta, and Beijing Gulf were developed to create a platform for growth by TNC's as foreign firms do not want to invest in capital intensive projects long gestation period and makes investor a hostage of fortune (Guha and Ray, 2000), three out of five busiest ports in the world are in Shanghai. Shanghai Yangshen deep water port is the busiest port of the world and handles 443 million tones of cargo. As a result of these structural changes made 430/500 TNC's (220 only out of 500 for India), and 40,000 foreign invested companies have opened office in Shanghai.

Strategic infrastructure of China can be demonstrated with the Shenzhen SEZ creation and development. The 1979 reforms created four SEZ's. The first SEZ was in Shenzhen. Shenzhen used to be small village and a fishing area (70,000 residents, 325 sq miles area) but due to the reforms initiated over the last twenty five years it is one the most modern places in the world. Modern Shenzhen has 7 million population, area of 2020 kilometers, produces \$40 billion in GDP, has 120,000 foreign TNC's in active

operation, and is the sixth largest port in the world. Shenzhen is the only city in China that has a land port, sea port, airports, and stock exchange of its own. As a result of SEZ's China's global trade exceeded \$1 trillion in 2004. Exports from SEZ's account for 35% of GDP. Merchandise exports have grown by 15% during 1989-2005.

Strategic policy initiatives taken by Chinese government were providing economic freedom and creating openness during the period 1978-2005. Government intervention reduced over time and in 2005 85% of the manufacturing was outside non-state sector. Government allowed joint ventures between diaspora and local residents, gave incentives, tax holidays, promoted exports, and wages were kept low due to allowing free competition. Lease and ownership rights were provided to foreigners. Tax exemption on importing machinery, free movement of goods between SEZ designated areas, rebates on export duty, liberal entry and exit policies were adopted. Foreign currency transactions were allowed in SEZ designated areas. Stock market was created and trading was allowed in foreign shares (B type). Decentralization was conducted and provincial governments were given powers to negotiate contracts. Visa norms and zoning laws were simplified for foreigners. Foreign firms could form Wholly Foreign Owned Enterprise (WFOE) in China from 1986 onwards. Bilateral tax treaty has also helped in attracting investment. Cheng and Kwan, (2000) found that there is a positive relation between SEZ and regional income in attracting FDI to China. River boat transportation and 'industrial clusters' helped in reducing infrastructural bottlenecks and reducing costs. Share of foreign affiliates increased from 9% in 1989 to more than 50% in 2005. Therefore, freedom and openness adopted by China had an impact on FDI inflows into the country.

Chinese diaspora which is 50 million people living in Honk Kong, Taiwan, Macau, Singapore (Wei, 2004) was attracted by the government by formulating preferential favorable policies in the SEZ's. Policies such as giving three years tax holidays and reduced rates after that period attracted diaspora. Hong Kong and Taiwan based manufacturers shifted to Shenzhen due to tax benefits given, proximity and cultural affinity with China. Diaspora tycoons like Gordon Wu and others contributed significantly to the Chinese growth. 'Guanxi networks' helped in building a loose connection between the diaspora community and the local manufactures (Cheung, 2004). It is estimated that 70% of initial investment came from diaspora Chinese (Zhang, 2001). Chinese diaspora essentially is considered more entrepreneurial and wealthy than Indian diaspora (Ramamurti, 2004). Had these diaspora Chinese not invested in China, it would have been a totally different story in China today (Ramamurti, 2004).

Flexible labor Laws were created in 1979 and 'iron-rice bowl' system of guaranteed employment was discontinued. Labor housing was freed and free movement of labor in economic zones was permitted. Initially 20 million people were unemployed but with the growth in industrial activity unemployment rate dropped. High performing workers were rewarded suitably and a merit-based system was introduced.

Statistical FDI model testing for China

The hypotheses formulation included- congenial business climate leads to FDI inflow in an emerging market. Congenial business climate includes structural changes in the economy, strategic infrastructure creation, and strategic policy initiatives (providing freedom, creating openness, diaspora contribution, and labor laws flexibility). Control variables used were market size (GDP), market growth rate (GDP % growth every year), political stability (interest rate), corruption (Transparency International Index), and exchange rate volatility (change over last year).

The research methodology adopted was testing the model based on above stated variables. Research design included a two-step approach- an OLS multiple regression followed by an autoregressive analysis. The independent variables were the constructs of the above stated hypotheses. Measures for testing the hypotheses were as enumerated above in the hypotheses.

Data for the FDI inflows in China was taken for the three main coastal areas- Shenzhen area, Shanghai Pudong economic zone, and Beijing Gulf area for the period of 1978-2005 for 28 years. Therefore there were $28 \times 3 = 84$ points same as for India. Data sources that were used -China Statistical Yearbook, China Foreign Economic Statistical Yearbook, Ministry of Commerce of the PR China website, www.shenzhen.com.cn; www.pudong.gov.in; www.shanghai.com.cn; www.szmj.gov.cn; www.chinesenewsnet.com; and www.english.peopledaily.com

Data for the Independent variables structural changes (measured in telephone lines within SEZ's), strategic infrastructure (GDP growth rate in SEZs) were taken from Eoromonitor.com and World Development Indicators for the years 1978-2005. Data for strategic policy initiative variable 'freedom' was taken from Heritage Foundation 1995-2005 and extrapolated for the period 1978-1994. For 'openness' variable data was obtained by $EX+IM/GDP$ for China for the period 1978-2005 from Euromonitor and International Financial Statistics Yearbook and tallied with data for individual SEZ's. For the variable 'diaspora' the FDI outflow from Hong Kong and Taiwan was taken as a measure and the data was obtained from SEZ as well as from Euro, and IFS data for the period 1978-2005. For 'labor laws' variable labor productivity ie $GDP/$ per hour of work was taken for the three SEZ areas for 1978-2005 from ILO and SIB for designated areas.

Control variables market size (GDP), market growth (GDP growth rate), political stability (interest rate), corruption (Transparency international), and exchange rate volatility (change over last year) were measured for the years 1978-2005 from the data obtained from Eoromonitor, IFS, and WDI 2005. For political stability and corruption data for the missing period was calculated from extrapolation of existing data.

The Data Analysis was done utilizing two-step process- OLS Multiple Regression Analysis and subsequently running an Autoregressive Models. The impact of the independent variables was tested on FDI flows in three Chinese SEZ's. Multiple Regression and Correlation (MRC) analysis was done to study the relationship. Pooled data was taken, cross sectional data from states and time-series (panel data) for the period 1978-2005 was taken for the study. Above stated measures were tested in OLS &

Autoregressive models. Heteroskedasticity was also tested. Model significance, correlation statistics (<0.7), and VIF statistics (<5.3) was checked and reported.

Overall the OLS model was found significant (90% confidence level, alpha equals 0.1, $F=48.39$, $p=0.001<0.1$, $R^2=75.2$, $\text{Adj. } R^2=69.9\%$). The adjusted model after dropping insignificant variables was tested and was also found significant. The autoregressive model was also found to be significant ($F=9.732$, $p=0.008<0.01$, $R^2=82.1$, $\text{Adj. } R^2=74.1$). Correlation matrix showed co linearity between corruption and exchange rate variable. Other variables did not have any multicollinearity problem as observed by the Pearson correlation matrix and VIF values were within prescribed limits. The statistical analysis and findings of Chinese FDI model suggests that FDI inflows in an emerging market in a globalize scenario are positively correlated with the congenial business climate actors comprising structural changes, strategic infrastructure, and strategic policy initiatives present in that market. These findings support the hypotheses. Control variables Market size and the rate of growth were also found significant. Political stability was found partially significant. Corruption was found insignificant. Exchange rate volatility was also not found to be significant.

How laggards can benefit from leaders?

Based on the Indian FDI model and findings from Chinese FDI model policy recommendations are made for creating a Congenial Business Climate in emerging market India. India has to leverage the 'endurance seeking' FDI behavior of the TNC's to attract 'linear FDI'.

India has to make structural changes in the economy. It has to duplicate success stories in the structural changes it has adopted till now. Metro Rail (DMRC) in Delhi & Expressway Network (Golden Quadrilateral) has to be created at all metro towns and roads linking these towns. Metro is a necessity in the entire NCR in Delhi Metropolitan area. Mumbai, Calcutta, Chennai, Bangalore, Hyderabad, and Poona should have Metro network. Expressways have to connect all parts of the country. In the telecommunications field, mobile telephony has been highly successful in India and its penetration should continue to benefit farmers and rural poor people. Indian railway is a highly inefficient organization that needs to be privatized like Chinese railway was done. Trailing Indian states of Bihar, Madhya Pradesh, Orissa, Uttaranchal, Uttar Pradesh, Chattisgarh, and Jharkhand -BIMAOR UT UP CHA JA (sick, get up and conquer)- 'the seven up' have to experience this conducive business climate growth.

Power and electricity reform is another area where India needs to take immediate steps. Power sector has given -26% returns on government equity employed in SEBs (Economic Survey, 2006). Removing subsidy on power, privatization of power distribution companies and SEBs is long overdue. Precedent is already there from the privatization of Delhi power board (DVB) as another success story that has to be emulated in all other state capitals. Free rural power scheme (RGGVY) should be shelved as it might have several implementation problems, instead private companies should be allowed tax holidays on providing power to rural poor.

India needs \$300 b in infrastructure development. Infrastructure development should be undertaken by using foreign exchange reserves & PSU offloading. India has reserves of more than \$150 billion in foreign exchange. These reserves should be utilized in developing the infrastructure. Offloading public sector equity will provide funds for developing infrastructure. Government has to focus in social areas of providing health and education instead of conducting direct business.

India has to overcome the current service sector myopia. Service sector growth should be supported with manufacturing growth as Indian population of 1.1 billion people cannot be employed in service sector alone and majority of the population from Bihar cannot be converted in computer literate call center executives. Much hyped Indian IT sector constitutes less than 2% of Indian GDP. Sam Pitroda recently commented that IT and BPO create only 3, 00,000 jobs against 10 million required. 79.9% of Indian population earns less than \$2 a day (Mehta and Shah, 2002) and services sector alone will solve their problems. India needs manufacturing boom to move idling labor force of (67% employed in agriculture producing 22% of GDP) from agriculture.

India has to diversify from developing service sector based 'core competence' (Hamel and Prahalad, 1990) being currently followed to developing 'dynamic capabilities' (Eisenhardt, 2000) to augment current services growth with manufacturing growth. Manufacturing is the answer to employ India's growing population that will exceed 1.5 billion by 2050 (IMF, 2005) and make India the most populous country in the world. China is catching up fast with service sector growth (40.26% in 2005) and its manufacturing model of Shenzhen is maturing into service model of Shanghai. Similarly, India has to move to manufacturing to compete with China. Even in R&D, that is thought of as an Indian stronghold, China filed for 943 US patents as opposed to 495 filed by Indian investors in 2004-05 (Economic Times, April, 30, 2006).

Paradigm shift in Indian manufacturing is required. India has to move towards skill-neutral mass manufacturing. As Chinese working age population ages by 2015 and burden on the economy increases, India has an opportunity due to its 'demographic dividend', having the highest young working population in the world. Despite manufacturing growth of 9% in last three years, the number of jobs in manufacturing remains the same as 1991, at 48 million, which is one third of China's manufacturing labor force (The Economic Times, July, 7th, 2006). Current manufacturing pattern has created a 'job-less growth'. Backward 'seven-up' states do not have majority of educated people so a skill neutral 'mass-manufacturing' will help employ large number of unemployed youth. Coastal areas in Bihar such as Gopalpur might be an ideal place for setting up large manufacturing units that can be 'export-oriented' to feed large US west coast market.

India is developing 100's of SEZs that are small in size. Chinese SEZ are large-Hainan SEZ for example is of the size of Kerala. The right strategy for India might be rapid formation and showcasing of large but few SEZ's on east coast to involve BIMAOR UT UP CHA JA states. Indian government might have developed 5-6 large

SEZs of 40-50 square miles each instead of allowing 100s of SEZs (Morgan Stanley report on SEZ, September, 2006). Despite having started earlier than China in SEZ formation in 1965 at Kandla, India has not achieved much on that front. SEZ act of 2005 enacted in February 2006 has not achieved any tangible gain till now, currently large real estate companies are busy grabbing land from state government at throw away prices, for tax incentive purposes, extending tax benefits when they expire in 2009, and the government is treating applications on 'case-to-case' basis to suit individual interest. Most approved applications are either in landlocked areas or are in the developed states. Diaspora should be allowed to be board members and commissioners in SEZs. World class infrastructure should be backed up by world class human resource ownership. Decentralized working vested in commissioners with minimum bureaucratic intervention will help develop these SEZs. World class infrastructure having banks, townships, shopping malls, golf courses, swimming pools, recreation centers, prominent quality school franchises, and airports, etc. will attract diaspora to work and live in these SEZs. World retail giants like Wal- Mart, Target, and Rite Aid can be allowed to enter these SEZs.

Indian ports are congested and plagued with bad management. Creating large ports in open spaces from scratch in a state like Bihar will help in developing 'state-of the art' ports that can handle large ships directly. Port to be developed in Bihar and Orissa should have 'deep bed port' facility. The 'seven-up' states can provide cheap labor for these (Ray, 2004) ports. These ports can cater to the markets of the west coast of the USA i.e. California. Port management has to be privatized and private sector participation in terms of 'Build-Operate- Transfer' has to be welcomed. Modern techniques such as just- in-time management, supply-chain-management, and third party leasing and operations should be adopted to improve efficiency.

Strategic policy initiatives will help create conducive business climate in India. India fortunately, more by default than by design, has a high quality human capital at the top with western educated economist as the Prime Minister, a scientist as the President, an economist at Planning commission, a newly created knowledge commission with leading personality as its head, and a Harvard educated finance minister, etc. If India cannot achieve phenomenal growth now, it will never be able to reach the top. Current Indian bureaucracy and polity will thwart cataclysmic changes but Indian intelligentsia and intellectuals have to take leadership and propel economic growth. India cannot afford to be ruled by uneducated politicians or their henpecked bureaucrats. India needs a new order. A recent initiative by some young diaspora Indians to quit their high paying US jobs and form a political party called 'Paritrans' and work at grass root level is a welcome step in this direction and such movements have to be encouraged. This is the first time since Indian independence that the Indian youth is coming forward with the feeling of committing themselves to national objective, the same sentiment that prevailed during the freedom struggle before 1947, the government has to sense this pulse and promote it.

Freedom and parity to TNCs by PSU-offloading and by tariff reduction, is desirable. PSU privatization has witnessed a complete moratorium in last decade. Privatization of Banks and Oil companies will provide competition and free capital for infrastructure

development. Government in a developed country, such as in the US, does not own Banks or Oil companies then why should the Indian government control them. Creating a holding company to receive funds from PSU privatization will help channelize investment in to infrastructure projects. The Indian family owned businesses should be allowed a level playing field with the TNC as traditionally Indian business houses have enjoyed privilege at the hands of the government (Khanna and Palepu, 2004). The role of bureaucracy has to be minimized in India. Government can create a Ministry of Foreign Investment and can attract 10% of GDP in FDI by upgrading FIPB. By allowing full convertibility of rupee on capital account, it will help to attract foreign investment.

Leveraging Diaspora strength might be a good option for faster Indian growth. If 20 million people of Indian origin invest \$1000 pm in India, it can get \$200 billion each year, which is close to 30% of current Indian GDP. Like the 'Guanxi' style program created by Chinese government India can have 'Sambandh' networks. These can be started like virtual communities exist for IT majors like Sun Microsystems. Diaspora entrepreneurs such as Lakshmi Mittal, Vinod Khosla, and Bose, etc. should be welcomed to invest in Indian SEZs on the east coast and have a 25% share of firms in SEZs. Diaspora can also provide TNC executives to benefit India from their global experience by giving them tax holiday for three- five years and then allowing 20% tax for them for five years as compared to 33% for domestic Indians. Dual citizenship can be provided much ahead of countries like US. Diaspora Indians can be minister and secretary of Ministry of Foreign Investment and should be participating in democratic process that is currently infested with 'criminalization', 'cliquization', and 'elitization'. Like the Chinese 'Chun- Hui' program 'Jugad networks' can be created. 'Ghar-Chalo' program should be initiated to welcome Indians back home through allowing them a single window clearance. Medical tourism should be developed as price of healthcare increases in the US and EU. Also, legal outsourcing should be developed as US is a highly litigious society and lawyer/legal costs are very high in the US. Diaspora doctors and lawyers should be encouraged to set up shops in India. Providing immediate visas on entry on Indian ports will attract foreign travel and their subsequent investments. Diaspora ministries should be set up in 'seven-up' states and the missions from these ministries should be sent abroad for conducting road shows to attract Diaspora and investments.

Labor laws have to be relaxed to promote mass production. Hire- and- Fire has to be introduced in PSU's and in the SEZs. Companies employing more than 1000 people should be kept within the purview of the labor laws, if at all (currently 100). SEZs have to be kept out of the scope of the Industrial Act. Labor Reserve pool, as suggested by Mahalanobis theory, should be created to deploy freed labor after layoffs in the public sector are initiated. Bankruptcy laws have to be simplified to attract free entry and exit for TNCs.

Discussion and Conclusions

The study tried to explore the determinants of FDI in emerging markets and took two largest countries in the world and rapidly emerging economies as an example of studying the phenomenon of foreign investment inflow in these countries. Surprisingly,

one country has grown at a phenomenal rate and the other is now trying to catch up but is still far behind. China has grown rapidly and India has trailed behind. China got \$60 billion dollars in 2005 in FDI and India did not even get \$6 six billion last year in FDI. The study tried to explore this phenomenon and to understand the drivers for attracting foreign investment in emerging economies.

India despite being the largest democracy in the world has lagged behind due to its focus on services and specialized skill based relatively small manufacturing model in contrast to China. Indian growth model has been based on IT, ITES, and skilled manufacturing which is dependent on the availability of human skill and capital in an emerging market. The study analyzed the impact of the human capital on FDI inflow into India during the reform period of 1992-2005 and found statistical evidence for the same. Indian growth has been positively related to its human capital stock. Also, the size of the Indian economy, its growth rate, its political stability, exchange rate volatility, and the extent of corruption have affected foreign direct investment in the country in last fifteen years.

China opened its economy in 1978 and within 25 years grew at a rapid pace to become one of the largest economies in the world with a promise of being the number one economy in the world in next thirty-four years. We analyzed this development and found statistical evidence that Chinese growth has been due to its adopting a congenial business climate comprising of furthering structural changes in the economy, creating strategic infrastructure on its coastal boundary by developing Special Economic Zones, and by evolving strategic policy initiatives. These initiatives include providing economic freedom for companies to grow, creating openness in trade related policies to increase export and import across its borders, formulating flexible labor laws to allow market oriented corporate structures, and engaging the Diaspora to develop its economy. TNCs, pursuing 'endurance seeking' FDI, owing to their maturing homeland market, prefer to go to the leading emerging market to obtain 'linear synergy' through FDI. The study found positive relationship between congenial business climate factors and variables and FDI inflow in China over last twenty-eight years. The study also found that the size of Chinese economy, its annual growth rate, and political stability have also played a role in attracting Foreign Direct Investment over last twenty-eight years.

India can learn lessons from China and create congenial business climate in the country to catch up with China. India can let the 'endurance seeking' FDI of TNC's enter its borders as TNC's try to move 'linear synergistic FDI' to benefit from exporting and marketing opportunity in emerging markets. Given other factors as constant TNC's would like to manufacture in India six times more as compared to China due to the exchange rate advantage and the relative strength of US dollar to Indian rupee as opposed to Chinese Yuan. If India can create structural changes at a faster pace it might attract more FDI and grow rapidly. India can also develop strategic infrastructure on its coast (East) by growing large incentive oriented SEZ's based on its demographic realities and by employing large population in labor oriented export manufacturing scenario, it can balance its service sector growth and grow holistically. Creating economic freedom for increasing private sector and TNC participation, opening trade to become more global in

its outlook, formulating flexible labor laws to attract free market determined organizational structures, and engaging Indian Diaspora in its economic activity- can help India in becoming a global player in the world economy.

Emerging markets can learn from the Chinese and Indian story and attract foreign direct investment to grow their economies and benefit from the current wave of globalization.

Academic Contribution

The study attempts to contribute to the academic literature on how emerging markets can grow by following a strategic intent. Strategic structure and strategic policy initiatives can help emerging markets by creating a congenial business climate and in attracting foreign direct investment from TNC's. The study attempts to add to the literature on the factors that determine investments by TNC's in the emerging markets. The FDI literature has mainly focused on the developed world and there are not many studies on rapidly growing emerging markets. This study contributes to the literature from an emerging market perspective. Traditional FDI determinants such as market size, market growth rate, exchange rates, agglomeration, etc. have been widely explored as contributors of foreign investment flows but factors such as structural changes, strategic infrastructure, and strategic policy initiatives including economic freedom, openness, labor flexibility, and Diaspora have not been explored much especially in emerging markets. This study fills that gap. The study is going to highlight the pattern of growth in the emerging markets to the existing literature.

The study is expected to show how laggards can learn from leaders in attracting more FDI to their countries and can guide countries such as Pakistan, Indonesia, and Nigeria in attracting more foreign capital. By 2050 the world population is expected to increase to 9.1 billion from 6.5 billion today. Nine countries are expected to account for half the world's projected population increase: India, Pakistan, Nigeria, Dem. Rep. of Congo, Bangladesh, Uganda, U.S., Ethiopia and China (Wall Street Journal, October 22, 2006). Following suggested Indian model of congenial business climate countries such as Africa can grow by supplying manufactured goods from North Africa to Europe and from North West Africa to the East Coast of the United States. Similarly, countries such as Indonesia can grow by catering to Japanese markets. This study contributes to the academic literature on what drives foreign investment in emerging markets based on issues faced by them and suggests solutions for them.

Managerial Implications

The study might help the Indian government and various interest groups in creating the right congenial business climate so that maximum FDI can flow into India and India can grow rapidly. The study intends to help the TNC's in understanding the determinants of growth in the rapidly growing emerging markets of the world and help plan entry and growth strategies in these markets depending on policies formulated by governments in pushing the reform process ahead. The study expects to help managers in understanding

drivers of growth in different emerging markets and be able to pinpoint areas where investments can be made by TNC's.

This study goes beyond just suggesting and testing a model of growth to emerging markets. It suggests how the model can be implemented to the benefit of an emerging market. The research answers the question- What are the different ways in which the model can be implemented to bring tangible gains to the emerging markets? The study does secondary research to arrive at qualified deductions that can be used to take meaningful steps in attracting FDI in emerging market. The study delves into these issues and recommends concrete steps that might be taken by the emerging market governments and other agencies in their efforts to grow their economies in the modern globalized world.

Limitations and Future Research

Though the research has been able to accomplish significant results, there are some issues that need to be addressed in future research and are limitations of this study. First of all, it is very difficult to obtain entire data on China and India over last twenty five years so the study makes some assumptions. India and China have grown at different time periods and India faces a lag of thirteen years; comparing different time dimensions can be misleading as their might be macroeconomic global factors such as Asian Crisis and Gulf war that might have influence on the flows into these countries differently. Also, this study does not statistically test all the factors that determine foreign direct investment in emerging markets because model restrictions do not permit including all the determinants, although most of the relevant determinants have been included. Third, this study only discusses China and India and does not include other emerging markets such as Brazil and Russia (BRIC countries). A study of FDI determinants for BRIC economies over last twenty-five years can add to the findings of this study. Also, sector wise analysis can be done to pinpoint the exact sectors that led to the Chinese growth and their relationship with FDI flows over time.

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