



**Foreign Investment
Facts
Without Comments**

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FOREWORD

In this booklet we are presenting some bare facts about Foreign Investment, and its linkages with technology, without any comments. On various occasions from different forums, the *Swadeshi Jagaran Manch*, has explained the *modus operandi* of foreign capital for establishing its economic imperialism throughout the developing world by eroding independence and sovereignty, and scuttling the indigenous growth process of all these countries.

The nexus between the rulers of the developed countries and the multi-national corporations, as well as the multilateral organisations, such as, World Bank and International Monetary Fund, was already playing havoc; now they have raised a new power-centre to expedite the process, that is, the *World Trade Organisation (WTO)*. Unfortunately, many political leaders, media persons and people from the academics have also joined this bandwagon, for their personal interests. They are conducting sustained mis-propaganda in the developing countries, to convince their peoples, that without foreign investment and foreign technology the latter would never be able to manage their own economies. While recent economic literature shows that, for ensuring a higher growth rate, the developing countries, have no option but to explore the indigenous sources of growth.

The *Manch* has elaborately stated its views on foreign investment policy and national technological policy. Regarding World Trade Organisation, nearly all developing countries are of the same view. The Resolution passed by the G-15 Conference at Kuala Lumpur on November 4, 1997, represents the views of most the southern countries.

We earnestly hope that this booklet would help in generating an informed debate on various aspects of foreign investment.

SOME FACTS ABOUT FOREIGN INVESTMENT

Q 1. What are the major trends in the flow of foreign investment in the world/ How much of this goes to the developing countries?

Attention on foreign direct investment (FDI), has coincided with the rapid increases in the magnitude of flows that this form of capital has witnessed during the 1990s. Total FDI inflows to both developed and developing countries in 1995 exceeded \$90 billion, increasing by more than two-and-a-half times since the beginning of the decade. The increase in FDI contributed considerably to the rapid growth of private capital flows to developing countries. In fact, during the 1990s, increase in aggregate net flows to developing countries has been primarily as a result of the buoyancy in the private flows. Official development finance, which has been largest component of external finance to developing countries in 1990, making up for almost 60 per cent of the aggregate net flows, declined in absolute terms between 1991 and 1994. Although it recovered moderately in 1995, the share of official development finance in the aggregate flows to developing countries had gone down to just a quarter (Table 1).

The pattern of distribution of FDI inflows as between country-groups and regions brings out clearly the nature of this form of foreign capital. Table 2 provides the details. An important feature of the FDI flows in years for which data are presented in Table 3 & 4 is the marked unevenness across country-groups. The tendency for FDI inflows to remain concentrated in a relatively small number of countries has been one of its key characteristics. This is not withstanding the fact that over the years the share of developing countries in the total inflows had increased. Although developing countries as a group accounted for 32 per cent of the inflows in 1995

as compared to 24 per cent in the mid-1980s, this increase in their share was brought about by the fast growth in inflows experienced by a few countries. In fact, the Asian region received almost 21 per cent of the total FDI inflows in 1995 and more than one half of these were accounted for by China. Two-thirds of the \$100 billion of FDI inflows to the developing countries in 1995 went to the South and South East Asian region, where, apart from China, the faster growing economies of the East and South East Asia received most of this form of capital inflows.

Thus, the developed countries and nine developing countries from the 'dynamic' Asian region (including China) accounted for more than 84 per cent of the total inflows in 1995. Africa and Latin America received less than 10 per cent of the FDI flows, which marked a decline from the high of more than 13 per cent that the two regions had received in 1994. The most significant dimension of the evenness in FDI flows can be seen from the experience of the 48 least-developed countries. Except for 1991, when these countries as a whole had received one per cent of the total inflow, in all other years, the share of the countries in question was substantially lower. In 1995, for instance, only 0.36 per cent of the FDI flows went into the poorest countries.

The pattern of FDI flows that had emerged shows quite clearly that most developing countries have had only a nominal role as recipients of capital. The flows have remained concentrated in a few countries and even as the share of the OECD countries has declined somewhat in the more recent years, most of the incremental flows have gone to countries in the 'dynamic' Asian region. The poorest countries in the developing world are yet to see any increase in their shares, despite the phenomenal increase in the FDI flows in absolute terms. Thus, the most likely scenario in the foreseeable future would be

that of a large number of developing countries chasing a small residual amount of FDI, i.e. after the inflows to the more preferred destinations have taken place. However, with an MAI in place, what could in fact happen is that owners of capital and other complementary resources like technology, could utilise their superior bargaining power much to their advantage. These circumstances could thus only perpetuate and even strengthen the unequal relationship between the TNCs and their host countries in the developing world, extensive documentation of which is available.

At a more fundamental level, the strengthening of the TNCs raises the issue of the relationship between the host country State and foreign capital. The multilateral system, it needs mentioning here, has been based on the explicit recognition of the sovereignty of the national states, and this premise is now being undermined as the pressures to establish the primacy of international capital have appeared. We would argue, in the following section, that the emerging perspectives on foreign capital needs to be altered and that the problems faced by the recipient countries in their interactions with FDI have to be taken into consideration in any multilateral regime on investment. The recipient countries' view need to be emphasised by considering some of the specific problems that they have had to encounter while dealing with the TNCs.

(Source: A paper presented at the National Seminar on, 'Trends in Industrial Scenario in Post-Economic Liberalisation', Organised at School of Management Studies, Chaitanga Bharthi Institute of Technology, Hyderabad).

Q 2. How much of the FDI flows to the Least developed countries?

According to the World Investment Report 1997, an annual

publication of United Nations, developed countries received 60 per cent of foreign investment and they accounted for 85 per cent of foreign investment outflow. The Triad (European Union, Japan and the United States) accounted for around 90 percent of both inflows and outflows of FDI from developed countries in 1996. Though the Table 3 makes it clear that the inflow of FDI to developing countries is steadily going up, but if we analyse this table in light of the Table 4, we find that the capacity of the developing countries as source of FDI is also gradually going up.

The 48 least developed countries (32 of them in Sub-Saharan Africa) have captured very little of the increase in FDI flows into developing countries during the 1990s. Hence it would be futile to imagine that the FDI would bring economic change in these countries. The reasons enumerated by the World Investment Report (p52) for low inflow of FDI in these countries are, small size of their domestic market (in terms of both population size and per capita income), poor infrastructural facilities, adverse climatic conditions, remote geographical or land-locked positions (in some cases) and political instability.

Q3. What is FPEI and how it is different from FDI?

Foreign portfolio equity investment (FPEI) is a contribution or participation in the equity capital of firms. In principle, FPEI is distinguished from FDI by the degree of management control that foreign investors exercise in a venture. Portfolio equity investors usually provide only financial capital by purchasing shares of a company without any involvement in the company's management. FPEI typically has a shorter investment horizon than FDI, sometimes just a few weeks or months, although this horizon can extend to much longer than this also. The type of investor is also different:

while FDI investors are firms engaged in the production of goods and services, portfolio equity investors are more often either financial institutions, institutional investors (such as pension funds, insurance companies or investment trusts) or individuals, and are typically interested only in the financial returns of their investment.

(Source: UN, *World Investment Report, 1997*)

Q4. Are there any linkages between FPEI and FDI? If yes, then what are those linkages and how do they influence growth of an economy?

In practical life the differences between FPEI and FDI become very blurred:

The ownership threshold commonly used to distinguish FDI and FPEI is somewhat arbitrary. An investment is normally counted as FDI when it involves an equity capital stake of 10 per cent or more of the ordinary shares in an incorporated enterprise, or its equivalent for an unincorporated enterprise. This is held to indicate a lasting interest in, or a degree of control over, the management of the enterprise (IMF, 1993). An equity stake of less than 10 per cent is categorised as foreign portfolio equity investment.

However, minority-share purchases can in some circumstances involve direct management participation, and in some cases lasting management control can take place with a less than 10 per cent equity stake (as recognized by the IMF and OECD definitions of FDI). In the case of Japan, for example, Japanese companies sometimes hold less than 10 per cent of the shares of foreign suppliers of raw materials, but still have representation on the foreign company's board of directors and maintain a long-term business relationship with these companies.

The role of venture capital investors : These provide equity capital for young unquoted companies, often at the start-up stage, and are often very closely involved in managing them, either directly or indirectly, by providing advisory services. Although their overriding motive is to achieve a capital gain, venture capital investors often wait several years before selling their equity stakes.

Data constraints : Only a few countries (including major source countries, such as OECD members) have systematically recorded equity capital flows in their balance-of-payments accounts under categories that distinguish FDI from FPEI. The lack of accurate data on cross-border FPEI flows is a serious handicap for analysis. The recent nature of FPEI flows to emerging markets poses an additional challenge. A special effort is therefore made here to use data from a variety of sources: host countries, home countries and international financial institutions.

Flows of FPEI are intimately linked to the development of stock markets in recipient countries. Many venture-capital fund investments in unquoted companies are made with the expectation of reaping capital gains subsequent to the listing of such companies on the stock market once they become mature. Likewise, some country funds are set up in developing countries in anticipation of the establishment of a local stock market. With regard to mergers and acquisitions, there is a close relationship between FDI and FPEI. In many cases, cross-border mergers and acquisitions are considered as FDI transactions because they confer a lasting and significant management interest in the merged or acquired company. However, it is possible for such transactions to take place with a minority equity interest, in which case the transaction would be recorded as a FPEI flow.

There is a partial overlap in the motivations underlying FDI and FPEI. For both types of investment, the rate of economic growth (as well as potential rate of growth) of the host country are an important influence on decisions on where to invest. For efficiency-or asset-seeking FDI, this element may be of lesser importance. For instance, in the case of FDI made with the intention of rationalizing production or establishing an export base, the cost and skill level of the labour force, the state of physical and communications infrastructure, the host country's geographical location (distance to target markets), as well as the existence of free trade agreements between the host country's growth rate (UNCTAD, 1993). For market-seeking FDI, the size and economic growth of the market are particularly important determinant of FPEI flows. In a survey of international equity investment funds recently conducted by UNCTAD, the potential rate of economic growth was identified most frequently as being highly important investment decisions. Market size can have, however, an indirect influence in so far as the size of stock market capitalization, and hence its degree of liquidity, is in many cases related to the size of the economy. Political stability is also important for both FPEI and FDI; the same is true for the degree of volatility of exchange rates. For portfolio equity investors, the level of ease of capital repatriation and disclosure standards for companies operating in the local market appear to be very important. Typically, FDI does not attach an equally high degree of importance to the latter.

These differences highlight a major contrast between the investment motivations for FDI and FPEI. The overriding motivation for investment by portfolio equity investors is their participation in the earnings of local enterprises through capital gains and dividends. Hence, it is more important for them that capital be easily transferable and that disclosure standards be high. Transnational corporations

tend to be more interested in accessing markets and resources and, more generally, in the contribution that the investment can make to the competitiveness of the transnational corporate system as a whole (UNCTAD, 1995 a). The latter concern is particularly important for firms that have integrated international production structures and have an intra-firm specialization in production. In general, TNCs tend to have a longer-term investment horizon than portfolio equity investors, especially when their investment involves a capital outlay (in the case of greenfield investment, for example).

The contrast in motives between TNCs and portfolio equity investors is not, however, always so stark. In particular, the investment horizon of venture capital investment tends to be somewhat longer than for FPEI in general, and the existence of significant (and perhaps also long-term) management control is not unusual. In that case, it is very difficult to differentiate between FDI and FPEI. However, the principal underlying motives remain different. For venture capitalists, the foremost motivation is to share in the capital gains of the equity of a local enterprise when it is listed eventually on the stock exchange. The stock exchange acts as a mechanism through which venture capitalist “exit” the investment. Thus, venture capitalists, while closely affiliated with the management of the enterprise in question, are also focused for the duration of their investment on their eventual exit. Venture-capital investments, therefore, represent a case in which the linkage between FDI and FPEI can be quite strong.

The discussion above helps to illustrate why FPEI flows are more volatile than FDI flows. Since the prime motivations behind the two types of investment are mostly different, so are the investment horizons. Typically, it is easier for portfolio equity investors to liquidate their investments by selling their equity positions in the

secondary securities market than for TNCs to sell their foreign affiliates, especially if these are intertwined in international production networks or “sunk” costs are high. The volatility of FPEI flows may, however, vary with the type of mechanism through which an investment is made. In particular, venture-capital portfolio investment is less volatile than some other types of FPEI flows. Similarly, investments placed through large institutional investors (e.g., via country funds) appear to be less volatile than portfolio investments made directly in the local market; portfolio equity investments through closed-end investment funds appear to be less volatile than investments placed by open-end investment funds (for reasons examined below). Investment flows in the secondary market for depositary receipts do not affect the flow of funds in or out of the local stock market because trading activity is conducted on foreign stock exchanges. Thus the issue of volatility of FPEI flows does not arise in the case. Direct portfolio equity investment in the local stock market is probably the most volatile form of FPEI, particularly when such investments are managed by retail investors, who tend to invest more speculatively, and do not have access to the sophisticated investment methods or the extensive information and resources for research typically available to large institutional investors.

Q5. Is state really capable of controlling the inflow or the outflow of FPEI?

In order to answer this we quote here the editorial from the Financial Times, London, March 9, 1998. It says Asia’s financial crisis has highlighted the dangers run by economies that allow the build-up of excessive short-term debt to foreign lenders. This debt, cheap when it is borrowed, can later carry huge costs for whole societies.

These social costs suggest that there is a case, at least in principle, for government intervention to control short-term indebtedness to foreign lenders. The question is whether the costs and distortions created by controls outweigh their potential benefits. Controls on inflows of short-term capital were deployed in Chile after a financial crisis in the early 1980s. These controls appear to have helped shield the economy from the mood swings of foreign lenders, and the economy has for the last decade grown faster and more consistently than its neighbours.

Chile taxes all inflows of funds - except for foreign direct investment and new equity issues made abroad by Chilean companies. Loans or bank deposits originating from abroad require a 30 per cent deposit to be placed for one year at the central bank, paying zero interest. This applies to maturity, the shorter the maturity the higher the implicit tax. This rule has virtues not shared by all capital controls: simplicity and transparency. But its success is impossible to isolate from other policies. These include strict regulation of the financial system and a strong macroeconomic policy framework: fiscal surpluses, an authentically independent central bank and the "sterilisation" of capital inflows to neutralise their impact on the money supply.

Q6. How FDI inflow is correlated with the technology flows?

Theoretically it has always been claimed that the inflow of FDI would bring in advanced technologies for the host economies. While most regulatory measures as regards foreign technology agreements have been liberalised substantially, the boom in FDI flows to developing countries has not always been accompanied by a boom in technology flows. In China, technology payments did not increase in line with FDI inflows during the mid-1990s. This can be partly explained by the gap between when an investment takes place and when payments

for technology are made (although it is also possible that foreign affiliates do not always pay fully for the technology they receive or that perhaps they are not always permitted to do so). In the Republic of Korea, Singapore and Taiwan Province of China, however, technology imports and technology payments have tended to be high. This reflects the fact that technology flows are concentrated in high-technology industries, such as micro-electronics or new materials. In developing countries, royalty payments for manufacturing technology generally reach their peak only 3-4 years after the initial investment has taken place. Thus, higher technology payments associated with the large investment flows to developing countries in the 1990s are likely to materialize only in the second half of the 1990s. In the case of royalties for patents that can be absorbed rapidly in new products and processes, as is often the case for patent-related transactions among developed-country firms, the time gap between the initial investments and payments receipts for technology may be much smaller.

Differences in the pattern of technology flows between developed and developing countries. A high proportion of technology payments by, for example, Japanese and Western European companies relates to royalties for the use of patents. In few cases are royalties paid for unpatented know-how. These payments cover a wide range: from biotechnology, new materials and information technologies, to industrial automation, software, telecommunications, space and aeronautics. They also cover new patents in chemicals, food and beverages, machinery and equipment. In the case of developing countries, technology flows are directed to high-technology industries, mainly in the Asian newly industrializing economies, Brazil and Mexico. By contrast, much of technology flows to other developing countries, including China and India, relates to industrial know-how.

In sum, the liberalization of regulatory policies on foreign technology agreements has not been sufficient to bridge the technology gap between developed and developing countries. Whether the implementation of the Uruguay Round Agreement on trade-related intellectual property rights would lead to increased technology flows to developing countries is still unclear (UNCTAD, 1996). The evidence for developed countries so far suggests that, while stronger intellectual property rights are important for FDI in some industries (e.g., pharmaceutical) and can influence the speed of investment and technology flows, their effects on FDI often depend on such factors as the size of the domestic market, the structure of production factors, technological infrastructure and the macroeconomic policy environment.

(Source: *World Investment Report, UN, 1997*)

Q7. How sovereign are the states to control flood of FDI?

One of the traditionally held views has been that the right of the State to control foreign capital is unlimited and that this right flows from the exercise of sovereignty¹. The unlimited right of the State to control entry by an alien was in fact confirmed in the early years of the present century by the Privy council which held that: "one of the rights possessed by the supreme power in every state is the right to refuse to permit the alien to enter that state, to annexe what conditions it pleases to the permission to enter it and to expel or deport from the state, at pleasure even a friendly alien, especially if it considers his presence in the state opposed to its peace, order and good government, or to its social or material interests"².

¹ see for example, Sornarajah, M. *the International Law on Foreign Investment*, Cambridge University Press, Cambridge, 1994

² *ibid*, p. 84

The bargaining relationship has the two obvious components, namely the benefit that each side seeks and the concession each side is willing to offer. In concrete terms, the benefits that governments seek from the TNCs are in terms of positive contribution to the process of economic development that they have initiated while the TNCs seek to maximise their profits through better market access opportunities in their host countries. More generally, the parties involved in the negotiations seek to gain from the each other's strengths. The phenomena can be explained by using the table below.

The two fundamental bargaining resources possessed by host governments arise from the control over the two usual targets of the TNCs, namely, (1) the host country market, or (2) host country factors of production, such as raw materials or inexpensive labour. Only when countries have the above mentioned attributes do the TNCs get into the act of investing in these countries. Correspondingly, TNCs usually have at least two attributes that the host governments seek: (1) assistance in raising host country income through setting up of joint ventures in manufacturing, extractive industries or in the service sector which use proprietary knowledge possessed by the TNCs and, (2) providing access to markets abroad which help in increasing the foreign exchange earnings of the host countries. Based on these perceptions about the issues involved in the bargaining, the processes and the multilateral institutions through which negotiations take place are determined. Most of the negotiations involving governments and the TNCs in the past decades have taken place through the multilateral institutions under the United Nations system. The 1990s have, however, witnessed an end to the process of negotiations between the TNCs and the governments and it is this, that has, effectively changed the bargaining counter between the two sides. And with Agreements like the MAI being proposed, the ability of the nation states to develop their own perspective has been seriously

undermined. The implication of this is far larger than what has generally been understood. The inability of most states in the developing world to exercise control over their economic space would reduce to a mere irrelevance the entire process of multilateralism where individual states are expected to negotiate using their own economic spaces as the bargaining counter, a point we have tried to indicate above. Another issue which arises in the context of the perceived irrelevance of multilateralism is regarding the future of the poorer nations in the global economy. We had mentioned in the foregoing that the most significant aspect of a multilateral system, as has been recognised, is the protection it provides to the weaker partners in the global comity of nations. Empowerment of these countries to meet the challenges posed by the economically strong needs to be the singular objective of a multilateral regime and this perspective needs to be strongly underlined.

Q 8. Are the Transnational Corporations a major source of foreign investment?

In recent years TNCs are emerging as major source of FDI. The largest TNCs control the bulk of FDI stock in many major home countries. The top 25 outward investors control over a half of the outward FDI stock. The concentration is so large among top 50 TNCs in some countries as in Australia and Norway that they control 96 and 93 per cent respectively (Table 5).

(Source: *World Investment Report, UN, 1997*)

Q 9. Do the TNCs really have an overpowering effect?

Shell in Sri Lanka

The head of Sri Lanka's privatisation authority PERC (*Public Enterprise Reform Commission*). Rajan Asinathan had to resign in 1996,

amid the claims that his organisation committed the country to unfavourable conditions in a deal with shell. The privatisation authority had the plans of selling of the domestic gas distribution and monopoly to Shell. This followed a day's token strike by the dock workers at Colombo harbour. The revenue projections from the privatisation programme was SL Rs. 21 while actually PERC was getting SL Rs. 10 billion only in the deal. Moreover, immediately after the conclusion of the deal shell enhanced the domestic gas prices by 20 per cent.

(Source: *Financial Times*, December 12, 1996)

South Korean Giants Unite to fight Takeovers

South Korean conglomerates have decided to act jointly to suppress any hostile takeover bids in an effort to preserve economic stability and prevent domestic companies falling into foreign hands. The decision by the federation of Korean Industries, which represents the leading conglomerates, or *chebol*, came after several conglomerates tried to stop one of the country's first hostile takeover bids - an attempt by the *Dongbang* food group to acquire *Midopa*. *Midopa* has now placed its \$ 60 m bond issue with friendly buyers. South Korean law still bans hostile takeovers by foreigners. However, the *Federation of Korean Industries* (FKI) has decided to jointly protect the interests of the local companies. FKI officials complained that hostile takeover bids would disrupt South Korea's industrial competitiveness by forcing companies to divert money needed for investment during a period of sluggish growth into defence from corporate raiders. There are also fears that companies will become easy targets for 'greenmail' raids by foreign investors.

(Source: *Financial Times*, London, March 3 1997).

Q 10. What have been the trends in the foreign investment related policies and in the actual inflow in India?

(a) Policy Changes

Since independence India adopted a policy, which was not very open for the inflow of FDI. The stated objectives of this policy were the export promotion and technology transfer. At this point government did not think of prioritising any particular sector or industry where the FDI could be channelised as happened in some of the South East Asian countries.

Beginning with July 1991; the government introduced a number of changes in the country's regulatory policies. Among these, and particularly important from the point of attracting FDI have been the following:

- (i) de-reservation of many areas reserved for public sector enterprises.
- (ii) delicensing.
- (iii) doing away with registration under MRTPA.
- (iv) removing the general ceiling of 40 percent foreign equity under FERA.
- (v) lifting the restrictions on use of foreign brand names in the local market.
- (vi) withdrawal of the restriction on entry into low technology consumer goods.
- (vii) abandonment of the phased manufacturing programme.

(viii) diluting of the dividend balancing condition and export obligations.

(ix) liberalisation of the terms for import of technology and royalty payments.

(x) permission to invest upto 24 percent in small scale units.

(xi) investment proposals need not be accompanied with the technology transfer agreement.

In terms of the amounts approved, the FIPB occupies a far more important position compared to the RBI. While the RBI gave automatic approval in nearly one-fourth of the financial collaboration cases, the foreign investment associated with these proposals was six per cent of the total investments approved. But for the change in policy in January 1997, RBI approvals would have accounted for far less. In the context of the liberalisation of industrial policy, it is thus significant that much of the investment approved went through a formal procedure of approval unlike the automatic approval case where the investors may not be so serious. Also in the initial period, equity hikes by existing companies were approved automatically. It is only after a lot of public criticism of the manner in which the hikes were effected at prices considerably lower than the prevailing market prices, the terms were tightened. The automatic procedure is, however, more effective in technical collaboration agreements. Out of the 5,069 technical collaborations approved till July 1997, the RBI granted 2,798 i.e., nearly 55 per cent. At times one finds that while the investment approval is accorded by the Government, approval for technical collaboration for the same case is granted by the RBI.

The relative significance of financial collaborations in the total approvals has increased rapidly during the nineties. From about 10 to 15 per cent during the latter half of the 'seventies, the financial collaborations (FCs) accounted for a little less than one-third of the total FC approvals towards the end of the eighties. The share of the FCs increased further since liberalisation of industrial policy and exceeded half of the total since 1993. During 1996 they accounted for two-thirds of the total i.e., double of their share in the late 'eighties.

Historically, India's policy has been to encourage technology imports without financial participation by the technology supplier. This was intended to give the much needed boost to technological development as the recipients of foreign technology were expected to absorb the technology and develop further with the help of their own R&D and without the restrictions imposed by foreign collaborators. The danger of impedance by the technology supplier is far greater if he also happens to share the ownership of the Indian entity. Another reason for discouraging foreign investment, especially in low technology items was to encourage local industry to come up and to conserve foreign exchange which the foreign investment would have entailed in the form of dividend payments and dependence on imports. The new policy regime discarded much of the earlier rationale and allowed foreign investment in a much larger number of industries. Hence a sharp increase in the number and the relative share of financial collaborations.

(b) Extent of Foreign Ownership

Restrictions on the percentage share of equity allowed to foreign investors (40 per cent, as stipulated under the FERA) were seen as a deterrent to foreign companies to invest in India. It is, therefore, expected that removal of FERA restrictions on holding of majority

stake would encourage large investment inflows, especially from large transnational corporations (TNCs). It should, therefore, be expected that the distribution of companies in different ranges of foreign share holdings will undergo significant changes. One may recall that a number of branches and subsidiaries of foreign companies were operating in India prior to the enactment of FERA. The number of foreign subsidiaries came down substantially due to the implementation of the FERA³. This was in spite of the fact that majority foreign equity share was not banned in cases of high technology and export-oriented companies. Some of the companies, notably those in the drugs & pharmaceutical sector, voluntarily diluted their foreign equity to 40 per cent⁴. Thus in the liberalised industrial policy environment the preference for higher levels of foreign equity becomes visible both in case of new entrants as also for those which earlier diluted the foreign shares and shed the foreign subsidiary status. The distribution of foreign shares would also be related to the foreign investor's perception of the need for a local partner. It is easy to visualise that foreign investors would normally prefer to have an Indian counterpart instead of going all alone in a regulated environment partly because the environment does not

³ *The number of Indian subsidiaries of foreign companies came down from 202 in 1973 to 66 by March 1988. The number of foreign branches was reduced to nearly 300 by 1981 compared to 541 in 1972. See: S.K. Goyal, "Directory of Statistics of International Investment and Production in India", a study prepared from the United Nations Centre on Transnational Corporations (UNCTC), 1990.*

These companies could, however, retain full control over their Indian affiliates through restrictive clauses in the Articles of Association of the affiliates.

permit full ownership and partly to enable them find their way around the regulations. This would be particularly true for new foreign investors. It is quite clear that by associating Indian collaborators, the foreign investors also obtain access to the local network of contacts, political support, business and operational advantage. Avoiding discrimination at the administrative level could also be another motive for associating with a local industrial group.

(c) Approved Foreign Investment

The government approved investments increased substantially since the adoption of new economic policies in 1991. The size of foreign investments approved in 1981 was nearly Rs. 10.9 crores. The peak year during the 'eighties was 1989 when the approvals aggregated Rs. 316.7 crores. Even during the first year of liberalisation, i.e., 1991 approved investment shot up to Rs. 534.1 crores from the low of Rs. 128.3 cr in 1990. Till July 1997 i.e., during the six years since the policy liberalisation, official estimates indicate that the approved foreign direct investment was of the order of Rs 1,28,000 crores. Out of this as much as Rs 1,01,000 crores or about four-fifths was approved during the last two and a half years. During the current year, which marked the further liberalisation of the foreign investment policy, approvals in the first seven months have already exceeded the approvals for the whole of 1995. The increases in approved investment remain substantial inspite of the decline in the exchange rate of rupee over the period⁵.

At the point it is necessary to mention that the approvals since 1994 include Global/American Depository Receipts (GDR) issues and

⁵ In 1992-93 one US \$ was equivalent to Rs 20.649 which by 1996-97 reached Rs. 35.5

Foreign Currency Convertible Bonds. These are essentially portfolio investments and lack the essential criteria of control over the enterprise and hence should not have been included in the direct investment figures except with the purpose of showing a healthy approval position. Had the GDRs not been included, the approved investment for 1996 would have been lower than the amount for 1995. If the GDR amount of about Rs 16,000 crores is taken out, the approved investment works out to Rs 1,12,000 crores for the six years. There is a possibility of some of the other approvals having been included though these would not strictly qualify as direct investments.

While the approvals seem to have grown significantly over the past six years, India's share in total global inflows is very small. Even within South, East and South-East Asia its share was only 2.27 per cent; though it marks a significant improvement over the 1.37 per cent share during 1985-1990⁶.

(d) Industry-wise Pattern of Approvals

FERA sought to channelise foreign investment into high technology and export-intensive sectors. Even while retaining the basic concept of selectiveness, the post-July 1991 phase enlarged the scope for foreign investment. At the end of 1989-90, manufacturing sector accounted for 8 per cent of the total FDI stock of Rs. 2,705 crores⁷. Plantations had a share of 9.5 per cent. Within the manufacturing sector, Chemicals & Allied Products stood at the top followed by Machinery & machine Tools, and Electrical Goods & Machinery in

⁶ UNCTAD (1997), *op.cit.*

⁷ See RBI, "India's Foreign Liabilities and Assets: as on March 31, 1990", *RBI Bulletin*, August 1993, pp. 1031-1051.

that order. Liberalisation of industrial licensing is the most important policy decision which can be expected to influence sectoral pattern of FDI. It also appears that to generate a demonstrative effect certain high profile collaborations had to be approved initially⁸. Moreover, with the emphasis on exports of non-traditional and those which were hitherto treated as low-technology based industries, the possibility of changes in industry composition of foreign investment has increased. Another major policy change in the new regime is with regard to drastic contraction in the public sector reserved areas notably power and telecommunications.

It is not secret that relative investment for MW of power generation was revised downwards by foreign companies after the issue became controversial. Policy makers failed to do their homework properly before according approvals and announcing projects. Had sectoral policies preceded approvals, the rate of implementation could have been probably smoother. Also, in case, if the Indian partners or state governments try to protect the local interests (e.g. Indian Oil Corp in case of East Coast Refinery⁹, Madhya Pradesh government in case of diamond mining in the state¹⁰, IDBI in the case of steel plant

⁸ *Indeed, an attempt was made to justify the approval given to Coca-Cola on these lines.*

⁹ *The points of contention were: (i) demand for higher share by Hindujas, (ii) tying up crude purchases with private promoters group companies and (iii) using the joint venture for marketing the products of private promoters.*

¹⁰ *De Beers which was initially tipped to get the assignment is known to market all the produce under their control through their London-based Central Selling Organisation for which they earn a commission. The company controls over 70 percent of world rough diamond*

in Orissa¹¹, Gujarat Government in the case of Parmar Refinery¹²) which resulted in delays, or even abandonment of a project, official machinery is not at fault. It is a reality that when it comes to extracting the maximum out of the ventures for themselves. NRIs do not lag behind any other. Tikoos and Balsaras are the other prominent NRIs who promised too much but delivered too little¹³. Compiling and sharing of experience in dealing with major investors may help in avoiding pitfalls.

(e) Takeovers and Implementation of FCs

Significantly, even the low level of inflows have altered the structure of many consumer goods industries substantially. In the liberalised policy environment, Indian entrepreneur seems to have lost his bargaining power and well-known Indian brands have been taken over by TNCs providing them a ready market with lesser competition from local industry. The process is continuing. Takeovers have the

supply. They regulate supply of roughs and in the process are known to delay development of new mines and to cut back production. Russia has been having a tough time in arriving an agreement with the group and has decided for open tender for some of its mines.

¹¹ Caparo Group was unhappy with IDBI for not agreeing to the higher debt equity ratio (3) suggested by them for financing the project.

¹² Press reports (1993) on the project reflect the hollowness of the claims of the promoters.

¹³ We observed in case of some NRI projects, the foreign promoter tried to unduly benefit from the venture at the cost of local shareholders. The inflows on their count may indeed be notion. See: S.K. Goyal, et. al. (1994), "Foreign Investment Approvals: an Analysis" (August 1991-July 1993) Institute for Studies in Industrial Development, New Delhi.

additional implication that they do not add to new production capacities or employment opportunities¹⁴. On the contrary, they are likely to add to the growing outflows of foreign exchange. A survey conducted by us in 1993-94 revealed that the major consideration for the Indian parties in entering into a collaboration agreement was to get superior technology. 'Access to foreign funds' was way below in the ranking¹⁵. One implication of these observations is that had the official policy not been liberalised the Indian promoter could have refused foreign stake taking advantage of the fact that the policy prohibited foreign investment in many small and medium projects, raising funds from the public was not a problem given the promising stock market. We have seen earlier that in many collaboration projects, the foreign share was quite small.

The recent controversy over ICI of UK attempted entry into Asian Paints, its major competitor in India, once again focused the attention on TNC takeover of Indian companies. When Parle's brands were sold to Coca Cola not much hue and cry was raised nor when TOMCO was taken over by Hindustan Lever. One reason for this could be that in the latter two cases, the Indian promoters withdrew on their own while in the former, the promoters are resisting the TNC's entry. The fact, however, is that in many other cases the ownership of Indian companies changed hands affecting market structure significantly. Probably what has not attracted much attention is the transfer of units as distinct from takeover or merger of a whole company (See Table-6&7 for an illustrative list). For instance, after the transfer of two plants (one has already been

¹⁴ This, however, does not mean that the taken over companies would not get new technology and production capabilities in the future.

¹⁵ S.K. Goyal, et al., (1994), *op.cit.*

transferred to the joint venture with Peugeot and the other one is proposed to be transferred to the joint venture with Peugeot and the other one is proposed to be transferred to the venture with Fiat), Premier Automobiles will be a pale reflection of its original self even though, it might remain a company 'owned by Indians'. This route was adopted for entry into consumer durables and machinery sectors. In a broader sense, hike in foreign share and entry of hundred per cent foreign-owned companies, setting up of parallel operations by TNCs and even crowding of the Indian market with foreign companies (with possible reduction in number and size of operations of locally owned companies) could also be interpreted as leading to diminishing role of Indian partners and general investors and consolidation of TNC control over Indian markets. Similar is the case with alliances whereby the competitors are turned into allies (e.g. transfer of Lakme's brands to a 50:50 joint venture with the Levers).

Had the Indian partners not resisted the foreign companies' attempts at consolidating their position, more joint ventures would have passed on to the latter's hands. The cases of TVS-Suzuki, Hero-Honda and Godrej-GE Appliances are relevant here. While Honda raised its stake in Kinetic Honda to 51%, it could not achieve the same in Hero Honda. GE is on a spree to consolidate its position in its joint ventures. It has already received approval for converting GE-Elpro Medical Systems into a wholly-owned one by acquiring Elpro's 49% stake. After initial resistance, Birlas seem to have yielded to the pressure from their Swedish partners to allow majority stake in VXL Landys Gyr. Birlas are also at the receiving end in Birla 3m and Birla Kent Taylor. Whirlpool took over TVS Whirlpool and Fuller Intl took over Fuller-KCP. Suzuki's attempts at gaining majority control over Maruti Udyog are well known. Some other relevant

cases are: Mercedes benz getting approval for increasing its share to 76% in its venture with Telco; Bridgestone planning to increase its stake to from 51% to 74% in its joint venture with ACC; Bausch & Lomb increasing its share in the Indian venture to 69%; and Henkel hiking its share to 70% in Henkel Spic. It may be interesting to recall that Pepsi started as a joint venture of Voltas, Punjab Agro Industries Corp and Pepsico, USA. The two Indian partners are nowhere in the picture now. Blue Star got edged out of Motorola Blue Star and Hewlett Packard India. Similar was the fate of Hinditron group in Hinditron. 2Tektronix and Digital Equipment, and Shrirams in SRF Nippondenso. Shrirams' share also got reduced in Shriram Honda Power¹⁶. One reason for these developments is that some of the joint ventures were formed through transfer of units and hence did not involve any cash investments by local partners. They obtained shares in lieu of the transferred units. When it came to expansion or bringing in additional money to sustain the venture which ran into trouble they were found wanting. On the other hand, after having gained experience, the foreign partner found the local partner to be dispensable. After all, for a joint venture both partners should have some strengths to offer to the venture. Once the Indian partners transferred the units, they neither had the money nor the marketing network with them. If the units make profits they could at least reinvest them. Technology was not in any case a strong point with

¹⁶ *The problem in dealing with large TNCs are highlighted by a recent case. Dabur India entered into a joint venture agreement with Osem of Israel. Osem agreed to take up a minority stake of 40% leaving the remaining to Dabur. In the meantime Osem was taken over by Nestle. Nestle is reported to be insisting for a majority stake in the joint venture (Excelsia Foods). See: "Nestle wants Dabur to give majority stake in JV to Osem", Economic Times, August, 24, 1997.*

them. At times foreign companies took over sick and sinking companies as illustrated by the recent takeovers by Polysindo group of Indonesia.

Conclusions

A few points emerging from the above presentation are as follows. In the new era when the emphasis is on size of foreign investment, approvals for foreign direct investment mark a significant rise as compared to the immediately preceding phase. The total approvals during the past six years are reported to be of the order of Rs. 1,28,000 crores. However, India accounts for only a small fraction of FDI inflows even to the developing Asian countries. The approvals suggest that while infrastructure sectors attracted maximum investment, consumer goods sectors have also had an important place in the approvals. The broad category of services attracted the maximum investment. The main factors behind the large amount of approvals seem to be the dereservation of public sector reserved areas; delicensing; and allowing larger share for the foreign investor. Granting of permission for subsidiaries and 100% foreign ownership gathered momentum during the past one and a half years.

Reporting of state-wise distribution of approved investment suffers from serious problems to be of much practical use for the policy makers. At best it might suggest the states which are ignored by foreign investors. Due to the increasing role played by tax havens, country-wise distribution of approvals and inflows are becoming less reliable. At the general level, developed countries have turned out to be the main sources of investment. NRIs seem to be playing considerable role. Scope exists for improving the monitoring and reporting system of approvals and inflows which is well within the capabilities of the official machinery.

Actual inflows have been rather low. Our estimates suggest that only about one-fourth of the approvals actually materialised as investment. Size and sector-wise distribution of the approvals suggest that a few proposals account for a major portion of the investment and if the problems related to these sectors are addressed to inflows are likely to pick up. The situation might improve in the future since the policy elements with regard to some of the major sectors (Power and Telecommunications) are falling into place. However, in view of the large investments and importance of the infrastructure sector, pricing would remain a crucial factor. Considerable sums can be siphoned-off both at the implementation stage and after the projects go on stream. Downward revision of cost estimates by power sector projects after public criticism, suggests the need for a cautious and transparent approach in case of large project costs. The relative importance of infrastructure and service sectors implies huge servicing burden in the coming years as these (except a few like software) cannot generate direct foreign exchange earnings on their own. The limited analysis of FDI approvals conducted by us suggests that the scope for export earnings is rather limited and if only certain sectors are going to deliver exports, they should be dealt with on a different footing altogether. In the new regime, large TNCs did not show any improvement in export orientation.

In relative terms approved FDI in consumer goods sectors is low, but by its sheer size it proved to be crucial in affecting market structures. Takeover of Indian companies has been going on in a subtle and gradual manner. In the liberalised environment, many Indian businessmen are finding it difficult to remain in control of their enterprises. Takeover, however, need not always reflect the weakness of Indian companies and brands. Indian businessman seem

to have been intimidated by the sheer capacity of large TNCs to sustain for longer periods backed by large funds. Indian experience probably should not come as a surprise since takeovers and privatisation are gaining importance as a form of capital flows. For instance, in USA, acquisitions represented 85 per cent of foreign investment in 1995 with new establishments contributing only 15 per cent¹⁷. Trends on the technology acquisition front also warrant policy review. An examination of public issues of capital reveals that FDI is playing only a limited role in the development of Indian stock markets. Increasing share of approvals for setting up subsidiaries further strengthens the view that large TNCs would bypass the Indian stock market.

If the emphasis is on larger investments and new production capabilities, probably FDI has to be further concentrated in infrastructure sectors with adequate safeguards for pricing. Individual states may not be very much concerned about the cost of technology imports or servicing costs of FDI. These should, therefore, continue to receive adequate importance at the national level.

(Source: A paper presented at the National Seminar on, 'Trends in Industrial Scenario in Post-Economic Liberalisation', Organised at School of Management Studies, Chaitanga Bharthi Institute of Technology, Hyderabad).

¹⁷ OECD, Financial Market Trends, June 1997, P. 21.

TABLE 1 : Behaviour of Major Components of Foreign Capital Flows to Developing Countries

Type of Flows	1990	1991	1992	1993	1994	1995
1. Private Flows of						
which:	44.0	61.6	100.3	154.2	158.8	167.1
Private debt Flows	15.3	19.0	39.6	40.3	43.8	54.8
Foreign Direct						
Investment	25.0	35.0	46.3	68.3	80.1	90.3
Portfolio Investment	3.7	7.6	14.1	45.6	34.9	22.0
2. Official Development	57.9	65.5	55.0	53.0	48.6	64
Total	101.9	127.1	155.3	207.2	207.4	231.3

Source: World Bank, *World Debt Tables*, 1996, Table 1.

TABLE 2 : FDI Flows by Host Region and Economy

Country/ Country-Groups	1984-89 Average	1990	1991	1992	1993	1994	1995
Developed Countries	193.1	169.7	114.0	114.0	129.3	132.8	203.2
Developing Countries	22.2	33.7	41.3	50.4	73.1	87.0	99.7
of which:							
1. Africa	2.7	2.3	2.8	3.0	8.3	5.1	4.7
2. Latin America and Caribbean	7.7	8.9	15.4	17.7	19.4	25.3	26.6
3. Developing Europe	0.03	0.1	0.2	0.2	0.3	0.3	0.3
4. Central and Eastern Europe	0.06	0.3	2.4	3.7	5.5	5.9	12.1
5. Asia	11.5	22.1	22.7	29.1	50.0	56.3	68.1
of which:							
China	2.3	3.5	4.4	11.2	27.5	33.8	37.5
Least Developed Countries*	0.5	0.2	1.6	1.3	1.6	0.9	1.1
Total	115.4	203.8	157.8	168.1	207.9	225.7	314.9

Note: 1. The Figures of FDI inflows to developing countries shown in Tables 3 and 4 do match because of the differences in the definitions of developing countries adopted by the World Bank and the UNCTAD.

2. Includes 48 countries.

Source: UNCTAD, *World Investment Report*, 1996, Annex Table 1.

TABLE 3 : FDI Inflow, by Host Region and Economy 1985-1996

	1985-90	1991	1992	1993	1994	1995	1996
Developed Countries	82.25	72.22	68.88	63.62	59.64	65.04	59.62
Developing Countries	17.42	26.23	28.55	33.49	37.89	30.43	36.86

TABLE 4 : FDI Outflow by Home Region and Economy 1985-1996

Developed Countries	93.20	95.78	89.18	85.66	83.51	85.98	84.98
Developing Countries	7.27	4.20	10.76	14.24	16.21	13.88	14.84

Source: UN, *World Investment Report 1997*.

TABLE 5 : The Share of top TNCs in Outward FDI stock, select countries, 1995

(percentage)

	Top 5	Top 10	Top 15	Top 25	Top 50
Australia	45.0	57.0	66.0	88.0	96.0
Austria	10.0	17.3	22.2	30.5	94.0
Canada	22.6	33.5	40.1	50.1	64.4
Finland	33.0	47.0	56.0	69.0	84.0
France	14.0	23.0	31.0	42.0	59.0
Germany	17.5	29.3	35.0	41.8	51.5
Norway	63.8	75.2	81.1	86.8	92.9
Sweden	23.0	37.0	48.0	59.0	76.0
United Kingdom	28.0	40.0	47.0	57.0	71.0
United States	19.0	33.0	42.0	51.0	63.0

Source: UN, *World Investment Report*, 1997.

Table 6: Illustrative List of Unit/Division Transfers to Joint Ventures

Unit Transferred	Remark
Apar Light Division	Transferred to the joint venture GE-Apar Lighting Ltd.
Compressor unit of Kirloskar Brothers	Transferred to Kirloskar Copeland.
Compressor units of SIEL Kelvinators	Taken over by and Tecumseh Venture.
Engine Valves Division of Kirloskar Oil Engines	Proposed to be transferred to a JV with MWP, subsidiary of Mahle, Germany.
Halol Pant of Hindustan Motors	Being used by the joint venture with General Motors.
Hinditron Equipments Mfg Co. Ltd. and Hinditron Computers Pvt. Ltd. (certain assets and know-how) and all the shares of Hinditron Information Technologies Ltd.	Acquired by Digital Equipment (India) Ltd. a JV between Hinditron Group and Digital Equipment.
India Linoleum Unit of Birla Jute	Transferred to Birlad DLW Ltd. a 50:50 JV

Kalyani Plant of Premier Automobiles Ltd.	with DLW of Germany. Transferred to Pal-Peugeot Ltd., a JV with Peugeot, France.
Kirloskar Filters Division of Kirloskar Oil Engines	To be transferred to a JV of with Knecht of Germany.
Kurla Plant of Premier Automobiles Ltd.	To be transferred to a JV with FIAT.
Luxor Pen manufacturing facilities	Transferred to Luxor Writing Instruments India Pvt. Ltd. a joint venture with Gillette.
Electric Metres Division of VXL Ltd.	Transferred to VXL Landys Gyr Ltd.
Motor Cycle Division of Escorts	Transferred to Escorts Yamaha Ltd.
Motor Cycle Engine Division of Hero Motors	Proposed to be hived off to a 50:50 JV joint venture with Rotax of Austria
Oral Care Divn. of Parle	Acquired by Gillette
Refrigerator Division of Godrej & Boyce Mfg.	Transferred to the JV, Godrej-GE Appliances (with General Electric, USA).
Speciality Chemicals Divn. of Max India	Transferred to Max Atotech a 50:50 JV between Max and Atotech BV.

Stabiliser Bar Division of
Jamna Auto

To be taken over by
NHK Jai Suspensions
Ltd. a new joint venture in
which the Japanese company
will hold 74% share.

Sugar Machinery Division
of KCP Ltd.

to FCB-KCP Ltd, a JV
with FCB of France.

Two and Three Wheeler tyre
plant of Ceat at Waluj

Transferred to South
Asian Tyres Ltd a JV with
Goodyear, USA.

Table 7: Raising the Stake

Indian Company	Foreign Partner Per cent	Stake hiked Per cent	Second hike Per cent	Third hike
Wimco	Swedish Match, Singapore	0-20		
IIS Infotech	FI Group Plc, UK	0-76	0-100	
Knoll Pharmaceuticals	Lupharma GmbH	40-51		
Sahney Paris Rhone	Remi India Holdings Inc	0-37	37-57	
International Instruments	Manesmann VDOAG, Germany	40-80		
Insilco	Degussa AG	34-51		
Britannia Industries	Associated Biscuits International	40-51		
Elf Lubricants (India)	Elf Lubricants, France	51-74		
Sandvik Asia	Sandvik AB, Sweden	54,6-75		
Silverline Industries	Subro Inc, USA	0-45	45-100	
Amar Raja Batteries	Johnson Controls	0-24,77		
Bombay Oxygen	Griesheim GmbH	0-30	30-50	
Cheminor Drugs	Schein pharmaceuticals Inc	0-18		
Swojas Energy Foods	Parmalat Finanziaria SPA	0-51		
Havell's India	Geyer AG	6.22-13.89		
Lumax Industries	Stanley Electric Co, Japan	11.12-20		

GEI Engineering	Hamon Industries Thermique	0-30		
Nalco Chemicals	Nalco, USA	51-65	65-80	
Narmada Cement	Scancem International	0-25		
Abbott Laboratories	Abbott Lab, US	40-51		
Godrej Hicare	Sara Lee	40-51		
ITC Agro-Tech	Con Agra Inc	0-34	34-51	
Shriram Honda Power	Honda Motor Co	33-56		
Mercedes Benz Indian	Sulzer Corporation	4-51		
Henkel Spci	Henkel KgaA	24-51	51-77	
Caprihans India	Vereiningle Kunststoffwerke GmbH		0-51	
Tektronix (India)	Tektronix Engg Deve. (India)	40-51.38	62-69.38	69-100
Ind Global Shares & Sec.	Dresdner Kleinwort Benson	0-75		
Sona Steering	Koyoseiko, Japan	8-20		
Macmillan India	Macmillan, UK	40-51		
Bridgestone ACC	Bridgestone Corp, Japan	45.34-51		
Hindustan Oil Explor. Co.		Hardy Oil & Gas, UK		0-15.5
Bharat Starch Industries	AE Staley, US	0-23.5		
Maharashtra Glass & Agro		Saint Gobain	26-51	
Tata Telecom	Lucent Technologies	0-25.5		
Nestle India	Nestle SA, UK	51-54.62		
Kirloskar Cummins	Cummins Engine Co., UK	51-54		

Goodyear India
ITW Signode
Goyal MG Gases
Mannesmann Rexroth
Goats Viyella India
DCM Daewoo
Vickers System
Fuller KCP
Premier Instruments
ABS Industries
Armour Polymers
Pennzoil India
Gestetner India
DSP Financial
Gujarat Gas Co.

Goodyear Tire & Rubber Co.
ITW Inc, US
Hoechst Group
Manes. Rextr.GMB
Coats Viyella, UK
Daewoo Corporation
Vikers, US
Fuller International Inc.
Denso Corporation
Bayer Industries
Reilly Chemicals
Pennzoil Products CO.
Ricoh Co
Merrill Lynch
British Gas Asia

59.9-74

29.25-51

30-49

51-70

51-70

70-75

51-54

75-81

40-51

40-80

80-100

0-12.5

0-20

20-50.99

-32.43

47.5-95

49.5-51

29.41-40

0-44

44-60

**Foreign Investment
Facts
Without Comments**

By
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