OFDI between India and the LAC Region : A firm level motive analysis

Varma, Sumati and Nayyar, Rishika

Sri Aurobindo College (Eve), Delhi University, PGDAV College(Morning), Delhi University

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OFDI BETWEEN INDIA AND THE LAC REGION – A FIRM LEVEL MOTIVE ANALYSIS

Sumati Varma[1]

Rishika Nayyar[2]

ABSTRACT

India and the Latin America and Caribbean (LAC) region have emerged as major growth drivers of the world economy in the last couple of decades. Trade and investment relations between these regions have traditionally been rather insignificant but have picked up in recent years. Since 2000, Indian companies have invested about $12 billion in the LAC region across various industries. This paper examines the important issue of the motives driving OFDI between the two regions. It uses content analysis to identify the motives of the FDI transactions and the Chi Square test to find out the dominant motives driving investment from India to the LAC region across industries between 2000 - 2012. The study finds that Indian OFDI into the LAC is market seeking in nature and thus makes a significant contribution to the literature on FDI in the emerging markets context.

Keywords: India, LAC, OFDI, Motives

JEL Classification no : F21, F23, N76

[1] Associate Professor, Department of Commerce, Sri Aurobindo College (Eve), Delhi University (corresponding author) email id: varmasumati@yahoo.co.in. Ph:9811867951

[2] Assistant Professor, Department of Commerce, PGDAV College(Morning), Delhi University. Email: rishikadse@gmail.com. Ph: 9999277953

INTRODUCTION

The last decade has seen the rise of MNEs from emerging markets spearheaded by an impressive sustained rise in outward FDI (OFDI) led by countries such as Brazil, Russia, China and India. OFDI from emerging economies was recorded at US $ 143 billion in 2012, accounting for about 10% of world FDI flows, as compared to US $ 27 billion in 2000. (UNCTAD FDI Statistics)[3].

The earliest episodes of Indian OFDI were recorded in the 1960s and related to modest investments by large conglomerates such as the Tatas and the Kirloskars into Sri Lanka and Africa (Hansen 2007). This was followed by an increased flow of FDI in the 1970s and 80s, from the manufacturing sector to neighboring developing countries in the form of minority participation by Indian firms (Kumar and McLeod 1981, Lall 1983). OFDI till the 1980s was restricted by an inward looking development policy (Agarwal 1981) with procedural hurdles adding to the difficulties in investing abroad. The Indian investment story began in real earnest however, with the onset of economic reforms in 1991 and more particularly from 2000 onwards. The annual average OFDI from India rose from about US$ 5 Million from 1980 to 1990 to US $ 121 million in a decade from 1991 - 2000. The level of OFDI flows recorded a sharp uptrend reaching US $ 105 billion during the period 2006-2012 as compared to US $ 10 billion between 2000 -2005. (UNCTAD FDI Statistics)

Indian outbound FDI has undergone long term transformations in its character covering industrial structure, geographical composition, ownership controls, entry modes, motivations and source of financing since the country embarked on its liberalization journey (Hansen 2007). Prior to liberalization in the 1990s, India’s outward FDI flows were largely limited to its neighboring developing countries and were viewed as its contribution to south-south cooperation. The share of FDI to the developed world increased from 24% in 1980s to 44% in 1990s (Kumar 2008) and has further risen to about 52% during 2000-2010 (RBI 2012)[4]. The period from 2000-10 witnessed an unprecedented boom in outbound FDI activity, led by overseas acquisitions of firms in the IT and pharmaceutical sectors motivated by the search for markets and strategic assets directed largely at the developed world (Varma 2009). However during last couple of years developing economies have again become important destination of India’s outbound FDI, accounting for about 60% of total outflows. (UNCTAD 2013).

The international financial crisis and resultant slowdown in the developed countries has prompted Indian firms to search for new markets and unexplored destinations for both trade and investment. In

[3] UNCTAD FDI STATISTICS: http://unctadstat.unctad.org.

[4]. Address delivered by Harun R Khan, Deputy Governor, Reserve Bank of India at the Bombay Chamber of Commerce & Industry, Mumbai on March 2, 2012. Available at: http://rbi.org.in/scripts/BS_SpeechesView.aspx?Id=674

this context, Latin America's resilience during the crisis and its recent strong recovery has aroused India's interest in the region. Since 2000, Indian companies have invested about US $ 12 billion in the Latin America and Caribbean (LAC) region across various industries.[5]

The objective of this paper is to examine the strategic intent of OFDI into the LAC region across various industries between 2000-2012. The paper is organized as follows : Following the introduction, section II discusses the pattern of India's OFDI into Latin America. Section III lays down the conceptual framework, followed by a brief review of literature in section IV. Section V contains the research methodology and the last section concludes.

II. TRENDS AND COMPOSITION OF FDI FLOWS BETWEEN INDIA AND LAC

India and the Latin America and Caribbean (LAC) region have emerged as major growth drivers of the world economy in the last couple of decades. However, trade and investment relations between these regions have been rather insignificant in the decade of the 1990s, but showed signs of picking up after 1995. Considering the market potential of the Latin American region, the Ministry of Commerce, Government of India launched an integrated program "FOCUS:LAC" in November 1991. The program has been reviewed from time to time and extended upto 2014 [6]. The LAC region has recorded a growth rate of five per cent from 2003 – 08 backed by solid macroeconomic and fiscal management, as well as prudent financial and banking supervisory practices, and huge progress in lowering poverty. In this context India's gradual, but steady, opening to the world economy, its high savings and investment rate, and rapidly expanding middle class, whose demands for western consumer products is growing in leaps and bounds, offer enormous opportunities for expanded international trade and investment. In this context, the LAC region has emerged as a huge opportunity to be explored!!

During the last decade, the economic engagement between India and various LAC countries has grown significantly. The total merchandise trade between India and LAC region grew by over 12 fold from a modest US$ 1.97 billion in 2001-02 to about US$ 24.59 billion in 2010-11. Investments in LAC countries by Indian companies, including NRIs, also rose phenomenally.(FICCI LAC Division)[7] Since 2000, Indian companies have invested about $12 billion in the LAC region across various

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[5] "The other BRIC in Latin America: India." accessed at: http://www.americasquarterly.org/india-latin-america.

[6] FOCUS LAC PROGRAMME, Department of Commerce, Government of India. Policy document available at: commerce.nic.in/trade/international_tpp_lac.pd

[7] Report on FICCI Latin America and Caribbean (LAC) Division, can be accessed at: www.ficci.com/international/.../Latin- - -

industries[8].Within the LAC region, Brazil has received the major share of India's OFDI during 1991-2013 .India's Outbound FDI into LAC is distributed across industries, with the IT industry being the major target followed by pharmaceuticals, energy, construction, minerals & metals and agribusiness (Varma and Nayyar 2013).

III. CONCEPTUAL FRAMEWORK

A key issue in the literature on international business has been the *raison d'etre* of FDI, the basic question of why firms choose FDI as the mode of entry into a foreign market. This paper explores the motives of emerging OFDI from India into the LAC region using a typology developed by Behrman (1972), Dunning (1993) and UNCTAD (2006).

According to these studies there are four basic motives of FDI :

- Market Seeking
- Resource Seeking
- Efficiency Seeking
- Strategic Asset Seeking

Makino et al (2002) further classified these into *asset exploitation* and *asset seeking* motives of FDI. The asset exploiting motive focuses on the exploitation of firm-specific advantages or proprietary assets for outbound venturing. Asset seeking motivations, in contrast are more closely tied to using FDI as a means to acquire resources—strategic assets, including technology and marketing and management expertise to build or enhance competitive advantage.

Market Seeking FDI – Market seeking FDI is the most common type of strategy for developing country TNC's in the process of their internationalization. UNCTAD (2006). Firms seek to protect and expand their market share through FDI. Market seeking FDI is driven by the need to follow customers in the host countries, to preempt or avoid being pre empted by the competitors' entry into a particular host country, to produce products close to the local market so as to reduce the total delivered cost of firms' offerings. Trade supporting investments by the firm in a foreign location is also a form of Market seeking FDI. (Kumar 1998).

Resource Seeking FDI- FDI is driven by the resource seeking motive when firms invest in foreign locations to benefit from the comparative advantage of that country in respect of particular resources, i.e. to acquire resources (skilled and unskilled labour, natural resources) at lower real cost than it could be obtained in home country. The resources sought can be both tangible and intangible. While

8 "The other BRIC in Latin America: India." accessed at: http://www.americasquarterly.org/india-latin-america.

the former includes resources like unskilled cheap labour, skilled labour and abundance of natural resources, the latter includes technological, organizational and managerial skills.

Efficiency Seeking FDI- Efficiency Seeking FDI is driven by the desire of firms to increase their cost effectiveness by taking advantage of differences in the costs of factor endowments, economic systems and by achieving economies of scale and scope. Efficiency seeking FDI is also aimed at rationalizing the structures of already established market and resource seeking investments through common governance of and synergy building among geographically dispersed activities.

Strategic Asset Seeking FDI – The strategic asset seekers are those firms which engage in FDI to promote their strategic objectives – sustaining and enhancing international competitiveness. Assets such as R&D or technical knowhow, patents, brand names, novel product technologies, local permits and licenses, and an extensive network of distributors may usually take time to develop and are crucial to increase a firm's income generating resources and capabilities.

According to Makino et al (2002) market seeking, resource seeking and efficiency seeking FDI motives are considered to be asset exploiting, whereas strategic asset seeking motive is considered as asset augmenting or asset seeking. Makino also posits that firms from emerging markets are likely to target other large developing country markets for resource and market seeking FDI, both small and large developing or less developed country markets for resource seeking FDI and developed countries for strategic asset seeking and market seeking FDI.

REVIEW OF LITERATURE

Firms engage in FDI because they are motivated and have the capability to do so. Makino et al (2002) puts forth two distinct but complementary perspectives which explain the motives of FDI: asset exploitation and asset seeking. In the asset exploitation perspective, FDI is viewed as the transfer of a firm's proprietary assets across borders. In the asset seeking perspective, FDI is viewed as a means to acquire strategic assets (i.e. technology, marketing and management expertise) available in a host country. From an organization learning perspective, March (1991) suggested that FDI is an outcome of the desire of firms to improve returns, present return (leading to asset exploiting FDI) or future returns (asset seeking FDI). Asset exploiting perspective forms the bedrock of traditional IB literature on firm internationalization, which explains FDI as a tool of exploiting monopolistic (rent seeking) advantage in the host country (Kindelberger, 1969; Hymer 1976; Caves, 1971). In similar vein, internalization theory explains FDI as response to the market failure for rent yielding resources and an attempt by the efficiency seeking firms to reduce transaction costs of cross border activity (Buckley and Casson 1976; Rugman 1981). The traditional IB literature assumes that firms will internationalize on the basis of competitive advantages that allows them to secure enough returns to cover the additional costs and risks associated with operating abroad (Buckley and Ghauri 1999, Caves 1971).

Dunning's OLI framework bridged the idea of market power and transaction cost approach and explained FDI as an attempt to exploit ownership specific advantages in overseas market through the process of internalization.

Traditional viewpoints on firm internationalization failed to explain the new wave of FDI from emerging economies and FDI activity of "latecomer" firms. The uphill flow of capital from labour rich developing countries to the developed world did not fit the traditional IB literature on firm internationalization (Athreye and Kapur 2009). The asset augmenting or asset aeeking perspective of FDI suggests that firms engage in FDI not only when they have firm specific advantages that they want to exploit in foreign market but also when they want to and have the capacity (absorptive capabilities) to acquire complementary assets which are owned by firms in the host country, to enhance their competitive advantages (Dunning 1995, 1998 and 2000). Kumar 1998 explained FDI from Asians NIEs to developed countries as their effort towards enhancing non price competitiveness. The "latecomer" perspective directs attention to international investment as a means of addressing competitive disadvantages through asset augmenting or asset seeking outward FDI (Child and Rodrigues 2005, Makino et al 2002). Such "asset-augmenting" FDI can indeed help latecomer firms to catch up with their developed-country rivals (WIR 2006). Firms which lack rent yielding advantages are motivated to venture into international markets to acquire "strategic" created assets such as technology, brands, distribution networks, R&D facilities and managerial capabilities. Chen and Chen (1998) employed strategic linkage theory and network approach to explain how FDI is used as a strategic means for small and weak firms to access resources that investors do not possess. In response to rapid technological advances, asset augmenting motive has become more prevalent. (UNCTAD 2006). Varma (2009) found evidence of the market seeking motive as the dominant driver of overseas M&A activities from the Indian IT sector for the period 2000 – 06.

Following Makino et al (2002) and Dunning (2006:140), this paper posits that asset exploiting versus asset augmenting is not necessarily an "either-or" proposition and may also be pursued simultaneously. TNCs may emphasize one or other of "asset exploiting" and "asset augmenting" strategies at any given moment (WIR 2006). For long term survival and growth of organization, a balance has to be developed between asset exploiting and asset exploration FDI (March 1991).

V. Research Methodology

Data Sources and Methodology

This paper examines the dominant motives driving Indian FDI into Latin America. It is based on firm level data based on the report of United Nations Economic Commission for Latin America and the Caribbean -"India and Latin America and the Caribbean Opportunities and challenges in trade and investment relations" (ECLAC 2012)[9]. This is supplemented by published firm-specific information and media coverage (including their websites) to assemble a final data base.

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The study uses content analysis for establishing the motives of the firms' acquisitions' and for classifying them into different categories. Content analysis is defined as "a research technique for making replicable and valid inferences from data according to their context" Krippendorf (1980). Content analysis is usually done at two levels – manifest content – where the material is coded into words or letters in written material, audio or visual material; and latent content – where the underlying or hidden meaning is inferred from sentences/paragraphs contained in letters, documents or press releases.

Data on the motives underlying an FDI transaction was thus analyzed based on statements made by the top management of the firms in addition to reports in popular and business media (print and internet sources). Firms finally included in the study are those that are incorporated in India and have made investment in LAC during the period 2000-2012.

Data Description

The paper investigates motives of 102 FDI transactions across industries – IT, pharmaceuticals, minerals & metals, energy, construction, agribusiness and a miscellaneous category between 2000-2012. Based on the discussion in the earlier section, we identify the following motives of FDI

- Market Seeking
- Resource Seeking
- Efficiency Seeking
- Strategic Asset Seeking

Hypothesis Development

The paper posits that a firm's decision to invest abroad is driven by multiple rather than a single motive, i.e there can be more than one motive underlying an FDI transaction. Not only are the motives multiple but also diverse across industries i.e. they may vary in importance across different industries in the sample.

Proposition 1: All OFDI transactions have multiple motives.

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[9] Based on information from the report "India and Latin America and the Caribbean Opportunities and challenges in trade and investment relations' ECLAC (2012) http://www.iadb.org/intal/intalcdi/PE/2012/09631.pdf

Proposition 2: In a given OFDI transaction, a firm may simultaneously pursue a combination of asset exploiting and asset augmenting motives.

Proposition 3: There is diversity in FDI motives across industries in the sample.

Based on these propositions we develop the following hypothesis :
HYPOTHESIS: Let Pi, i = 1 – 4 be the probability of occurrence of any motive in a FDI transaction.

Ho : H_o: $P_1=P_2=P_3=P_4$
Ha : H_1: $P_1 \neq P_2 \neq P_3 \neq P_4$

In order to test the hypothesis we use the Chi Square test, a statistical test used to examine independence of occurrence in categorical variables.

Findings of the study

Since the paper posits that an FDI transaction can have multiple motives, we consider the frequency of motives in the FDI deals between the period 2000-2012.

Table 1 confirms the multiplicity of motives. For 102 transactions covered in the study, there are 135 motives. Figure 1 clearly shows that almost market seeking motive dominates in the total FDI transactions (49%) followed by resource seeking (24%), efficiency seeking (17 %) and the strategic asset seeking motive (10%).

DISTRIBUTION OF FDI MOTIVES

TABLE 1		
MOTIVES	**FREQUENCY**	**PERCENT**
Market Seeking	66	49%
Resource Seeking	33	24%
Efficiency Seeking	23	17%
Strategic Asset Seeking	13	10%
Total	135	100%

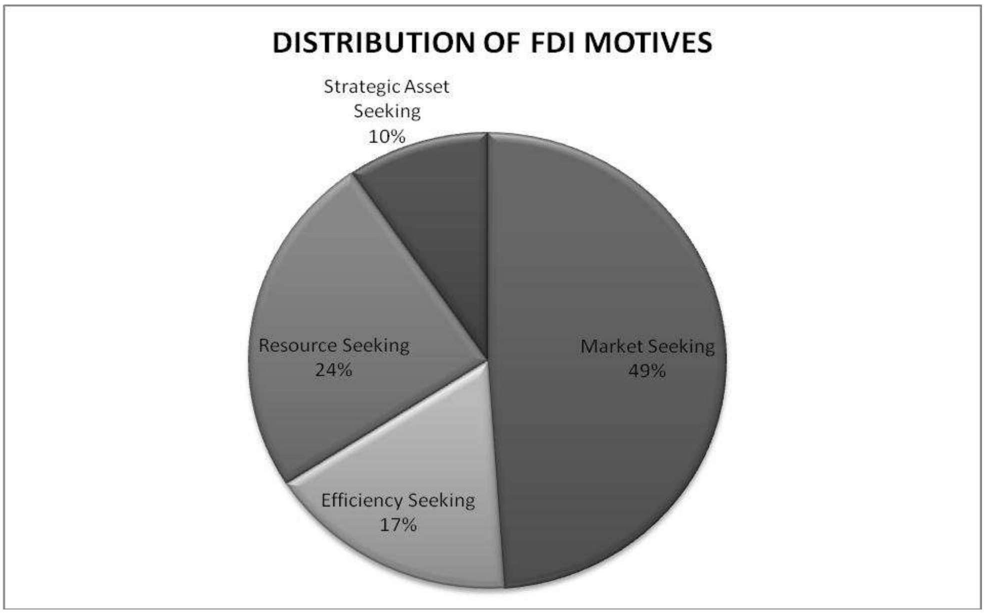

Figure 1

Given the multiplicity of motives, it becomes imperative to see if any particular motive or combination of motives dominates over another. To find out the dominant motive, we employ the chi square test (**χ2**), a statistical test used to examine independence of occurrence in categorical variables.

$\boldsymbol{\chi 2}= [\sum (f_o-f_e)\ \hat{}2/f_e]$

Where

f_o is the observed frequency of motives.

f_e is the expected frequency of motives

The results of the test (at 5% level of significance), are tabulated in table 2.

CHI SQAURE CALCULATIONS		
MOTIVES	**FREQUENCY**	**DISPARITY NUMBER**
Market Seeking	66	30.82
Resource Seeking	33	0.02
Efficiency Seeking	23	3.42
Strategic Seeking	13	12.76
TOTAL	135	
TOTAL (χ2) = 47.01		

Table 2

These results reject the null hypothesis that all motives are equally likely to occur in a FDI transaction. This implies that some motives dominate over others. To find out the dominant motive, we compute the disparity number . It is clear from the disparity number computations depicted in Table 2 that market seeking is the dominant motive driving India's OFDI into the LAC Region. The resource seeking, efficiency seeking and strategic asset seeking motives are dormant motives i.e they do not exert a significant influence on the firm's FDI decision.

Multiplicity of motives and the null hypothesis were tested for those industries in the sample which had a significant number of deals - IT, pharmaceutical, energy, and the miscellaneous category. The results indicate that the market seeking motive is dominant in the IT and pharmaceutical industry and in the miscellaneous category of firms. The resource seeking motives dominates in the energy sector. The Chi Square calculations and results are tabulated below (tables 3 -7).

CHI SQUARE CALCULATIONS (INDUSTRY WISE)

IT INDUSTRY		
MOTIVES	**FREQUENCY**	**DISPARITY NUMBER**
Market Seeking	32	40.09
Resource Seeking	0	
Efficiency Seeking	11	0
Strategic Seeking	1	9.09
TOTAL	44	
TOTAL ($\chi2$) = 60.18		

Table 3

PHARMACEUTICAL INDUSTRY		
MOTIVES	**FREQUENCY**	**DISPARITY NUMBER**
Market Seeking	12	11.07
Resource Seeking	0	0
Efficiency Seeking	2	1.59
Strategic Seeking	5	0.01
TOTAL	19	
TOTAL ($\chi2$) = 17.42		

Table 4

ENERGY		
MOTIVES	**FREQUENCY**	**DISPARITY NUMBER**
Market Seeking	1	1.79
Resource Seeking	12	20.64
Efficiency Seeking	1	1.79
Strategic Seeking	0	3.50
TOTAL	14	
TOTAL ($\chi 2$) = 27.71		

Table 5

MISCELLANEOUS		
MOTIVES	**FREQUENCY**	**DISPARITY NUMBER**
Market Seeking	16	11.57
Resource Seeking	2	3.57
Efficiency Seeking	3	2.29
Strategic Seeking	7	0
TOTAL	28	
TOTAL ($\chi 2$) =17.43		

Table 6

RESULTS					
Industry	**No. of Transactions**	**No. of Motives**	**Multiplicity of Motives**	**Null Hypothesis**	**Dominant Motive**
IT	36	44	Yes	Rejected	Market Seeking
Pharmaceutical	13	19	Yes	Rejected	Market Seeking
Energy	13	14	Yes	Rejected	Resource Seeking
Miscellaneous	19	28	Yes	Rejected	Market Seeking
TOTAL	**102**	**135**			

Table 7

CONCLUSION

This paper is an initial analysis of the motivation of the emerging FDI relationship between India and the LAC region. The study is based on firm level analysis of 102 FDI transactions from India to the LAC region between 2000-2012. We find that in keeping with the general trend of OFDI from India, the majority of transactions in this study were also from the IT and pharmaceutical industries. The market seeking motive emerged as the dominating driver of FDI for the complete sample of firms, confirming that FDI between the two developing country regions is asset seeking in nature. The market seeking motive also dominates in the IT, pharmaceutical and miscellaneous categories but the resource seeking motive dominates in the energy sector.

Market seeking FDI into the region can be attributed to the pull exerted by the LAC region as an attractive potential market , backed by strong growth, fiscal and macroeconomic and fiscal reform and supplemented by prudent financial and banking supervisory practices with huge progress in lowering poverty.

The data showed that FDI investment from the IT sector were from the large established veterans of the industry such as TCS, Infosys and Wipro alongside a number of mid sized and small firms, driven by the "near shore" advantages of a low cost bi lingual workforce that helps firms to service both the Asian and the American markets.

This was followed by investment from pharmaceuticals into Brazil, which is the largest pharmaceutical market in South America and eleventh largest in the world. Brazil has been a major export destination for the Indian pharmaceutical industry but FDI into the region received a major boost as a result of a major policy change which encouraged Indian firms to set up manufacturing units rather than use it merely as an export destination (Chaturvedi 2011). This is aimed at helping the Indian firm develop its 'regulation handling capabilities' in order to remain a significant player in the global market in the post TRIPS era (Guennif and Ramani 2010).The internationalization strategy of the Indian pharmaceutical industry has been a combination of collaboration with acquisition driven by the desire to tap the profits from the generics market opportunity as well as build their R&D capabilities. It targeted the western regulated markets for R&D in the context of drugs, vaccines and diagnostics that were off patent or about to be off patent. It also entered into contract research and custom manufacturing, bioinformatics for genomics based drug research and clinical trials for the larger western MNCs (Varma 2010). The strategy is clearly visible in its forays into the LAC region as well, driven by its immense market potential.

FDI into the energy sector is targeted at fulfilling India's requirements for a reliable supply of raw materials, of which the LAC region is a particularly rich source.

The present study may be extended to examine the role of institutional policy as a facilitator of FDI from India. A similar study comparing the motives of Chinese FDI in the LAC region would also be an interesting comparison.

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