

SAWTEE presentation

# Regional Investment in South Asia

Barriers, Opportunities  
and Facilitation

December 1, 2022

Sanjay Kathuria (CPR, Wilson Centre,  
ISAS, Georgetown and Ashoka)

(joint work with Ravindra Yatawara,  
Xiao'ou Zhu)



# Presentation Outline

- Context and approach
- South Asian outward investments and regimes
- Bilateral knowledge connectivity and trust
- Basic firm-level conceptual framework at the firm level
- Key features of Regional Pioneers
- Implications for firms and policy makers
- Conclusions



# Context and approach

# Why focus on investment and intraregional investment

- Economic linkages within South Asia are well short of potential, leading to foregone welfare gains for consumers, firms, exporters and workers
- Absence of regional buoyancy as bulwark
- Trade and investment are interlinked
- Value chains most dynamic part of world trade, and value chains closely linked with FDI
- Inward FDI (IFDI) can boost productivity and exports
- Outward FDI (OFDI) can boost exports, resilience, and profits
- Climate change and near shoring
- Can value chains be created in South Asia, as the world searches for alternatives to China? FDI plays a critical role here
- FDI can help reduce the volatility of trade in the region
- Region as a springboard for broader engagement

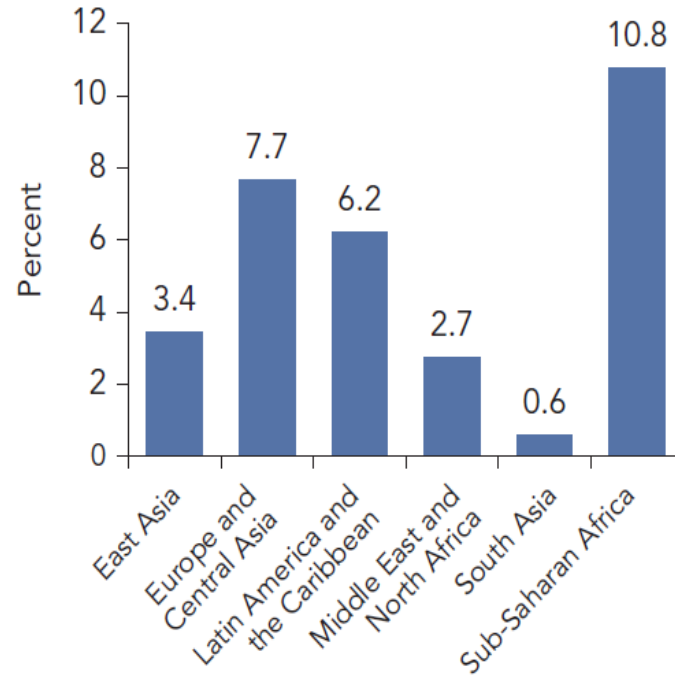
# CONTEXT

Fresh hope: regional integration likely to have become more compelling

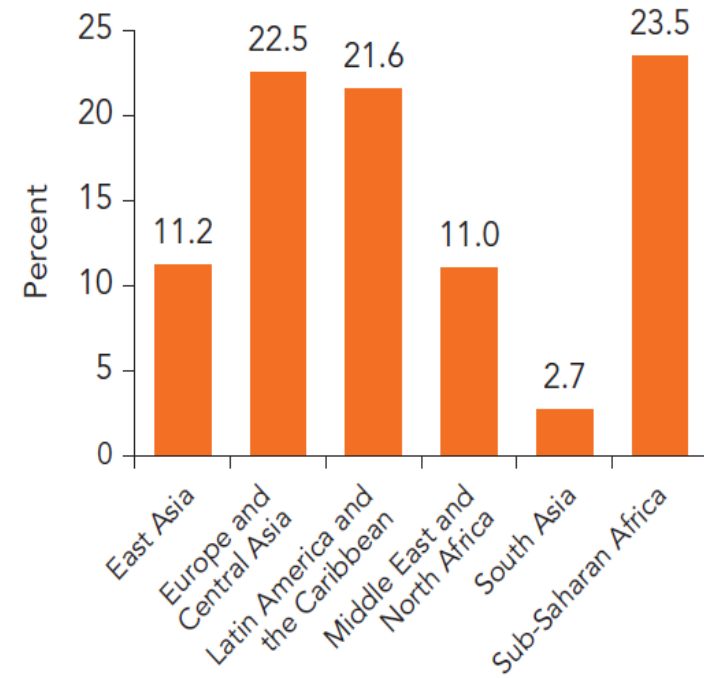
Intraregional FDI is rising but amounts to just 2.7 % of outward investment and 0.6 % of total inward FDI

Intraregional exports are expanding recently and amount to 7.9% of total exports

a. Intraregional investment as share of total IFDI from world, developing economies only



b. Intraregional investment as a share of total OFDI to world, developing economies only



Source: International Monetary Fund Coordinated Direct Investment Survey augmented data.

Integrative approach to two fundamental concepts help explain low regional engagement

## Connectivity

- **Knowledge Connectivity**
- **Digital Connectivity**

*In addition to*

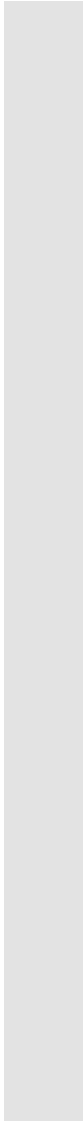

- Transport connectivity
- Trade costs

## International Engagement

- **Outward FDI**

*In addition to*

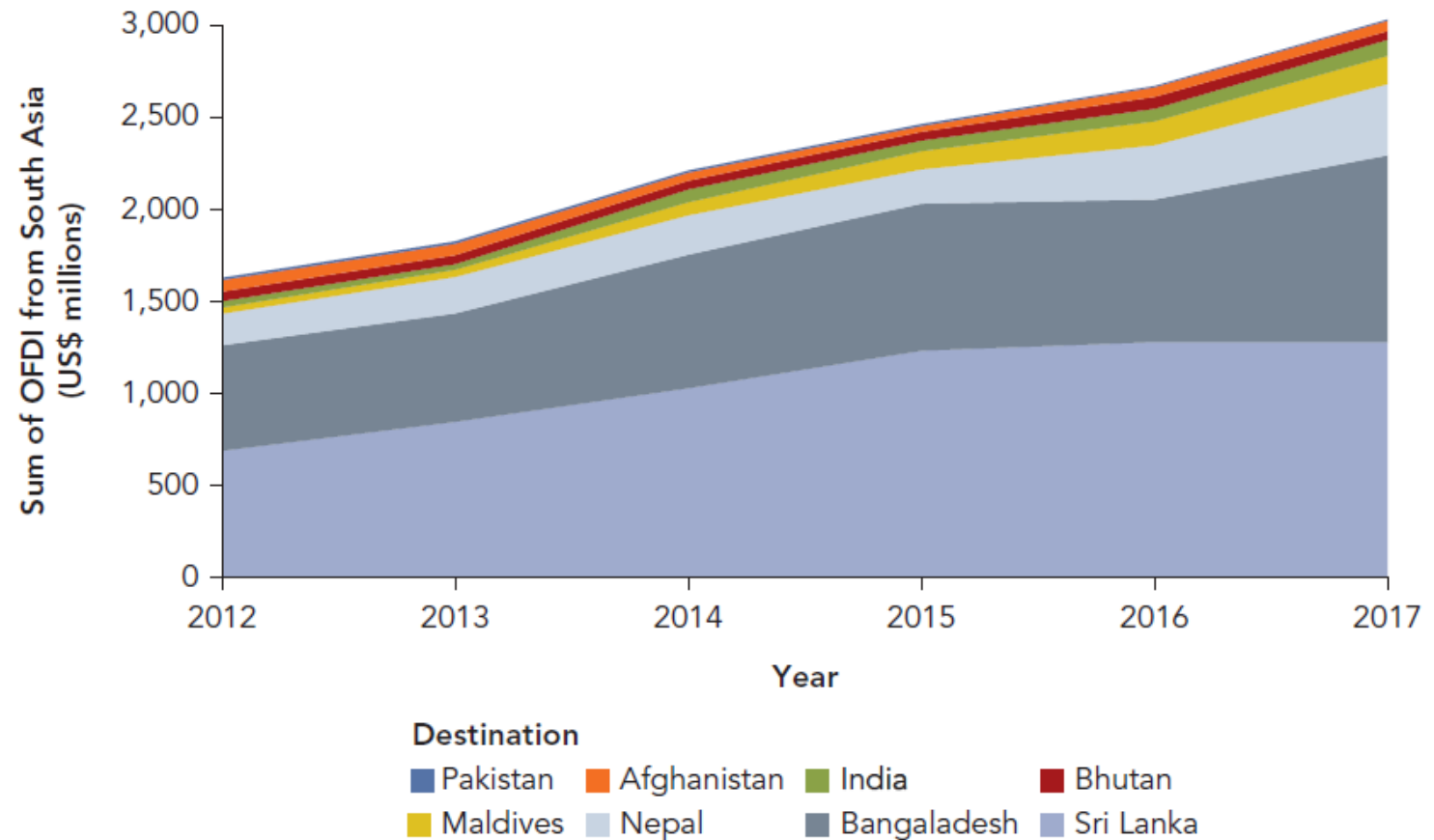
- Inward FDI
- Exports/Imports
- trade supporting FDI, production FDI, services FDI
- equity and non-equity engagements



# South Asian outward investments and regimes

Sri Lanka and Bangladesh are the largest recipients of South Asian intraregional investment (\$3bn)

Intraregional Outward Foreign Direct Investment into South Asia, 2012-17



Source: Augmented Coordinated Direct Investment Survey data, International Monetary Fund.  
Note: OFDI = outward foreign direct investment.



# Investment regimes

- **Outward investment regimes**

- *Restrictive* : Bangladesh, Bhutan and Nepal
- *Lack transparency* : Afghanistan, Maldives, Pakistan
- *Automatic approval*: India, Sri Lanka
- *Region specific policies*: India

- **Inward investment regimes**

- Improving but cumbersome by global standards, region specific policies in India

# OFDI Benefits from a value chain perspective

Important for policy context

- Allowing firms to develop scale and scope of production
- Capturing high profit or high valued-added segments of value chain
- Purchasing foreign intellectual property
- Achieving bargaining power through ownership
- Securing stable access to foreign raw materials
- Diversification of location to reduce exposure to country-specific shocks

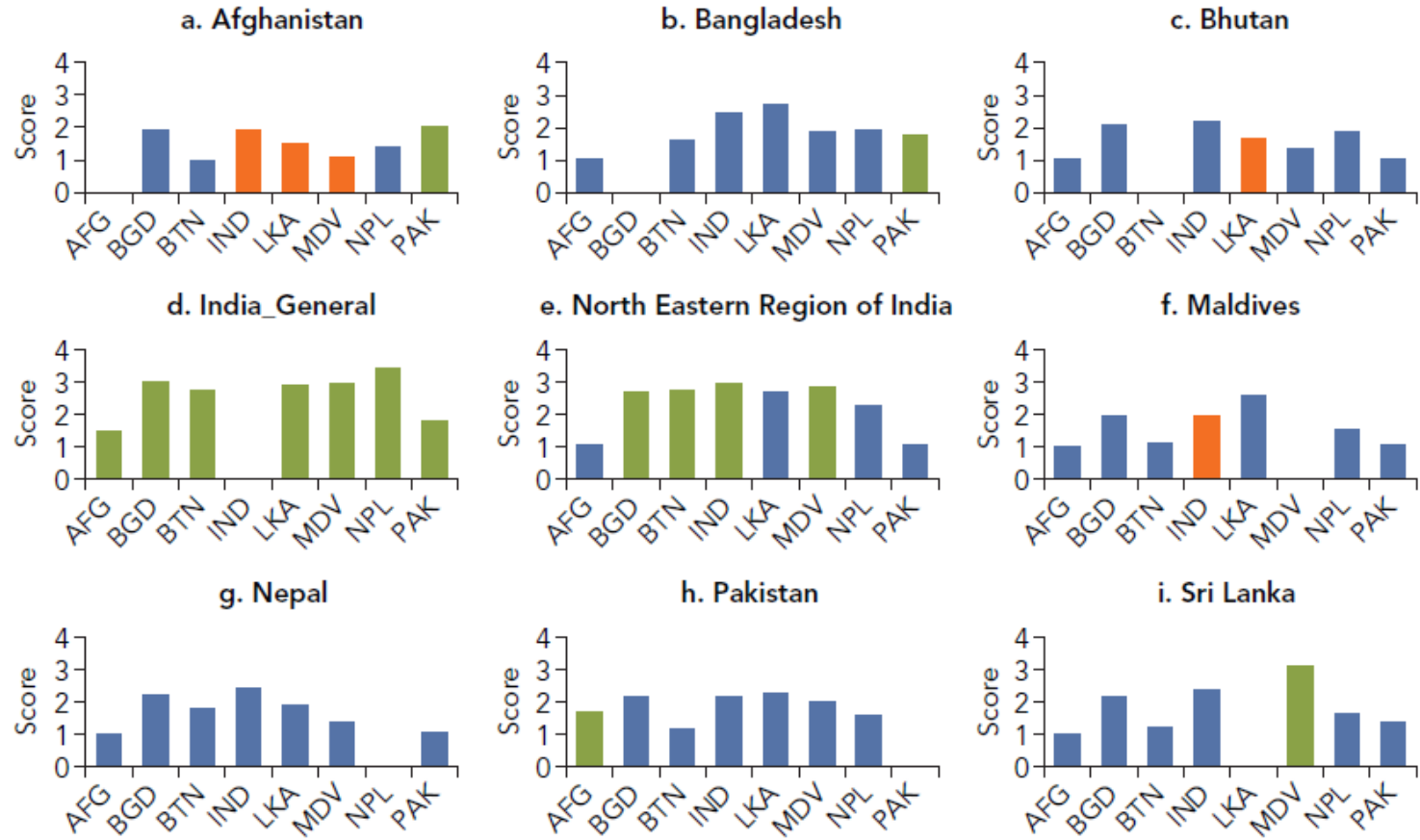
... and many others



Bilateral knowledge  
connectivity and trust

# Investment Pioneers face low and polarized knowledge connectivity

## Bilateral Knowledge Connectivity Score By Destination: Identification of Knowledge Surplus and Deficit Pairs



How well informed do you feel about the opportunities abroad?

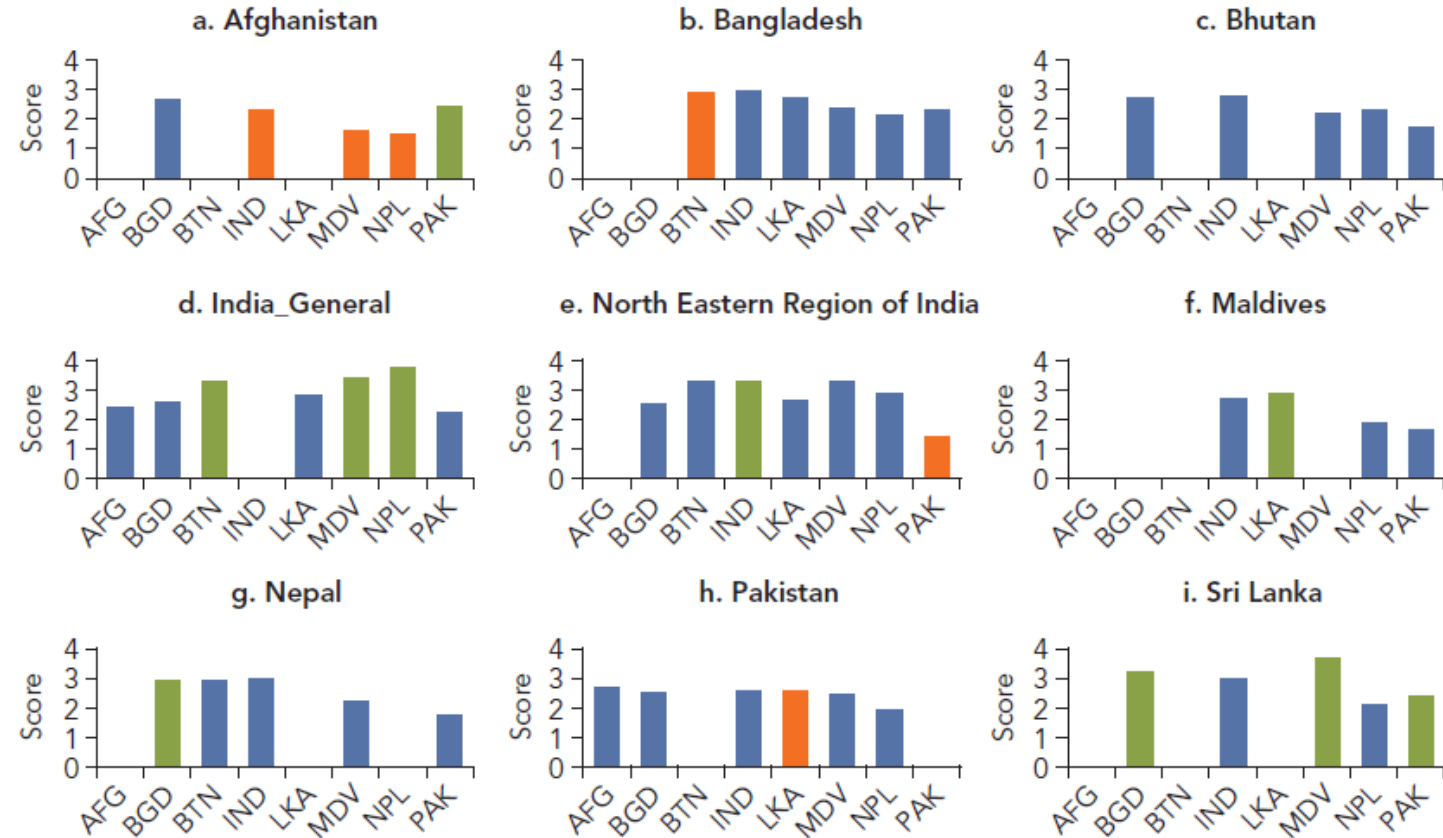
Source: South Asia Regional Investment and Value Chain Survey

Note: Score range from 1(low) to 4(high). Colored bars represent countries whose score are 1 standard deviation above (green) or below (orange) the home country average.

Scores are for bilateral pairs of countries with 30 or more observations.

# Investment pioneers face low and polarized bilateral trust

## Bilateral Trust Score By Destination



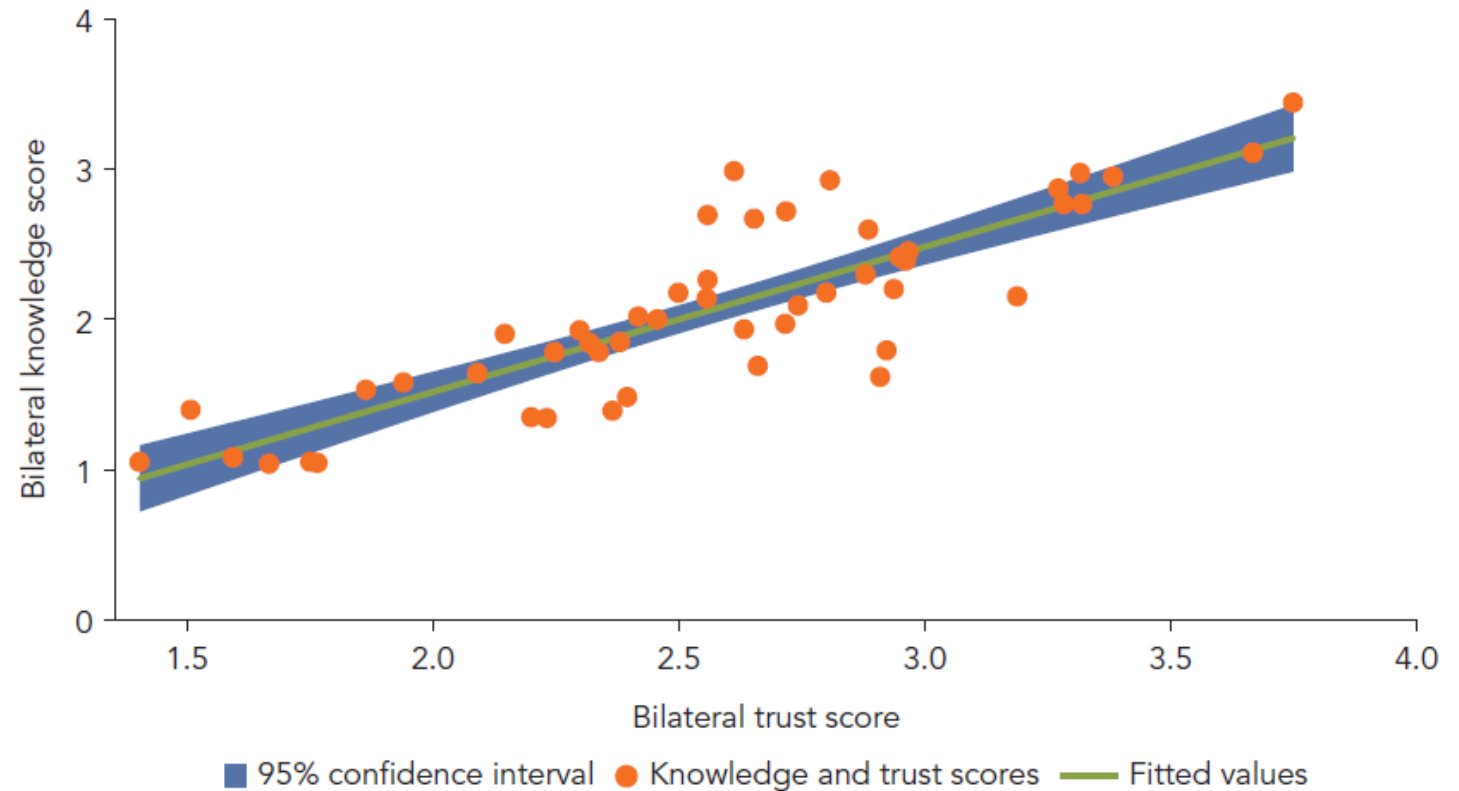
How much trust do you have in people from various South Asian countries?

Source: South Asia Regional Investment and Value Chain Survey

Note: Score range from 1(low) to 4(high). Colored bars represent countries whose score are 1 standard deviation above (green) or below (orange) the home country average. Scores are for bilateral pairs of countries with 30 or more observations.

# Knowledge connectivity - trust nexus: To know me is to trust me ?

The Knowledge – Trust Nexus



Source: World Bank calculated based on data from the South Asia Regional Engagement and Value Chain Survey.

Note: Scores range from 1(low) to 4(high). Each dot represents the average for a bilateral pair of countries. Scores are for bilateral pair of countries with 30 or more observations .

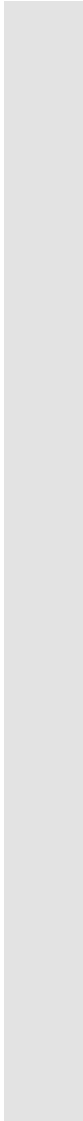



# Basic firm-level conceptual framework

## Basics of a conceptual framework

- All Activities Along the Value Chain
- Location and ownership decision for all chain activities
- Sunk Entry Costs ( affected by risk/ uncertainty, prior firm knowledge, destination features)  
 $f_{\text{export}} < f_{\text{trade supporting FDI}} < f_{\text{FDI}}$
- Value added distributed unevenly along the value chain (SMILE CURVE)
- Profit margins distributed unevenly along the value chain
- Corporate strategies –relational contracting; asset-light approaches, inventory strategies; high margin low volume vs. low margin high volume.





# Key features of Regional Pioneers

Diverse  
distribution of  
sectors of  
origin and  
investment,  
and many  
different  
motivations  
for investment

- Investors originate from a wide range of sectors, including manufacturing, wholesale and retail trade, transportation and storage, etc.
- Many different paths of investment pioneers
  - Soorty Enterprises: distribution investment in Bangladesh, to market denim fabric, and connect to global buyers; production investment followed three years later
  - Taj/CG Hospitality: joint ownership of hotels in Sri Lanka, with management services provided by Taj from India

# Features of Investment Pioneers

(>1200 firms  
econometric results)

High productivity firms

Large firms with surplus investment funds

Close distances

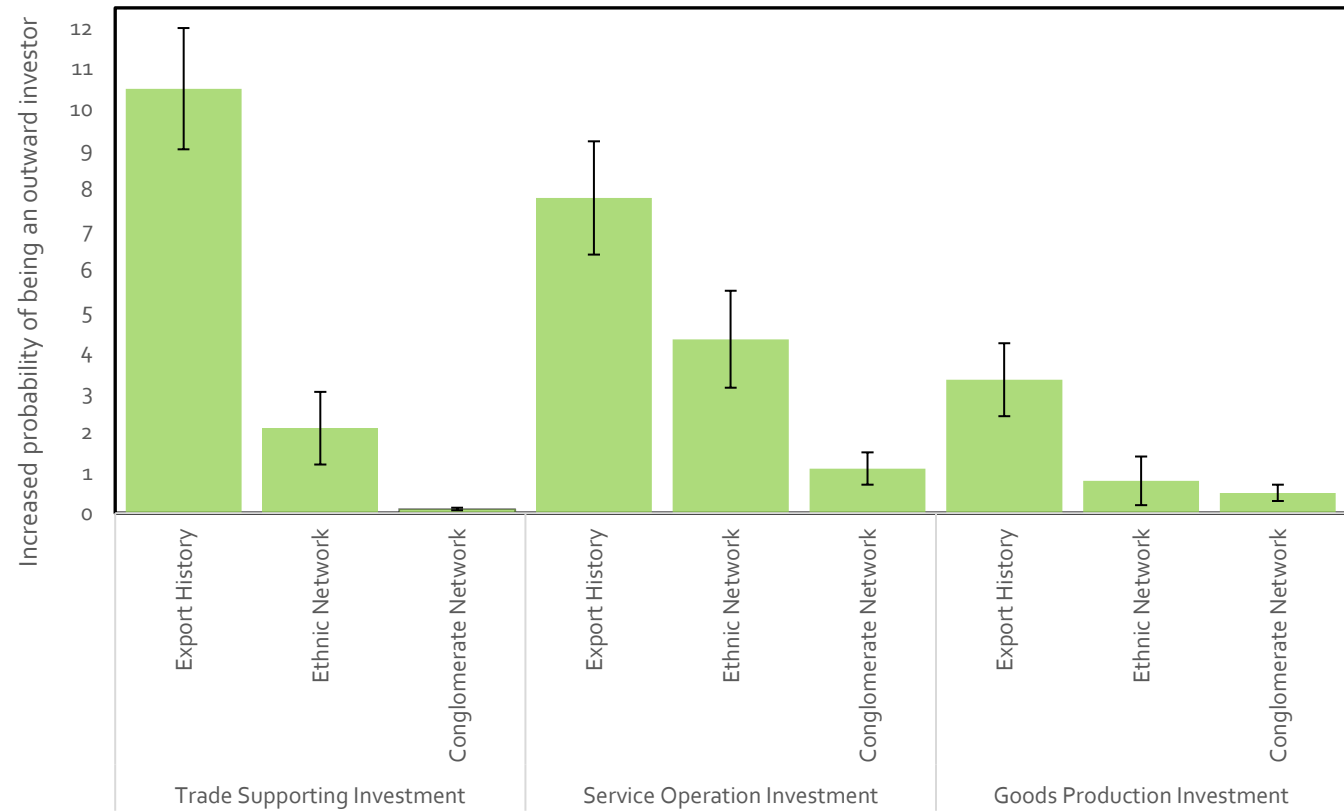
Founder/ CEO well-connected networks

Low communication costs

- Tend to follow a gradualist path
- Exporters
- Part of a Conglomerate
- Founder/ CEO risk appetite -part of a business community/ well known business family

Investors tend to follow a gradualist path

Figure 3: Increased knowledge through gradualist learning raises the probability of a firm to invest abroad





# Implications for firms and policy makers

# Implications for firms

- Many opportunities
  - Many paths
  - In high uncertainty, capital scarce environments ..
  - **“Start small, learn big”**
  - Can even start from outside and then home
  - Importance of networks
- **Importance of investment in knowledge connectivity**
  - Inter-conglomerate knowledge sharing
  - **Role for investment intermediaries**

Policy  
Implications –  
firm  
foundations  
for some of the  
actions taken  
in the past,  
and new  
suggestions

## An Integrated Approach to Cross-Border Engagement

### **Knowledge Connectivity – Network development**

Information dissemination, matchmaking events.

**De-regulating outward investment policies** -- creating an understanding that OFDI is an integral part of international engagement, firm resilience and competitiveness

**Smart inward FDI policies** – Focus on reducing entry costs. Attracting foreign investors already in region; those already present in non-equity /low equity modes; and exporters.

**Institutional aspects** – information/match-making role – investment promotion agency (IPA)/ board of investment, also for OFDI export development board. No need for new institutions.

**Digital connectivity** – continuing and accelerating smart initiatives, what helps trade also helps investment

# Knowledge connectivity

## **Knowledge Connectivity – Network development**

Information dissemination

Matchmaking events

Tapping industry veterans

Tapping cross-border investors to share their knowledge

No need to create fresh institutions, use existing bodies for IFDI and OFDI (embassies, high commissions, boards of investment, export development boards)



# Outward Investment Policies

## **De-regulating outward investment policies**

Create an understanding that OFDI is an integral part of international engagement, firm resilience and competitiveness

Sri Lanka is a prime example in South Asia of how firms have used regional and global platforms for enhancing competitiveness

Others could do it too

# Smart Inward FDI Promotion

**Smart inward FDI policies** – Focus on reducing entry costs.

Attracting foreign investors already in region, e.g., those in India, which has highest FDI inflows and global anchor investors in many sectors

Those already present in non-equity /low equity modes

Conglomerates already present – other firms in the group

Exporters in destination country

Work with those who have knowledge of such potential partners:  
Ministry of Commerce, Commercial wings of embassies, Board of Investment



# Conclusions

# Conclusion

- Welfare loss arising from inadequate intraregional economic cooperation
- Even more compelling reasons to engage, with COVID-19 accelerating earlier trends to value chain diversification, near-shoring, climate related pressure to shorten supply chains. Also, rising trade costs, decline in air transport capacity
- OFDI is an integral part of international engagement
- Knowledge connectivity – very neglected – is a key part of low trade and investment in the region
- Some promise in the regional pioneers story, with 65% of first investments within the region, based on the approach of cautious and incremental outward engagement and knowledge gathering
- Policy makers can encourage this, so that South Asia can indeed enjoy the “herd effect”
- Policy suggestions are light on the exchequer, and demand smart and sensible policy reorientation

# THANK YOU

## Regional Investment Pioneers in South Asia

The Payoff of Knowing  
Your Neighbors

Sanjay Kathuria, Ravindra A. Yatawara, and Xiao'ou Zhu

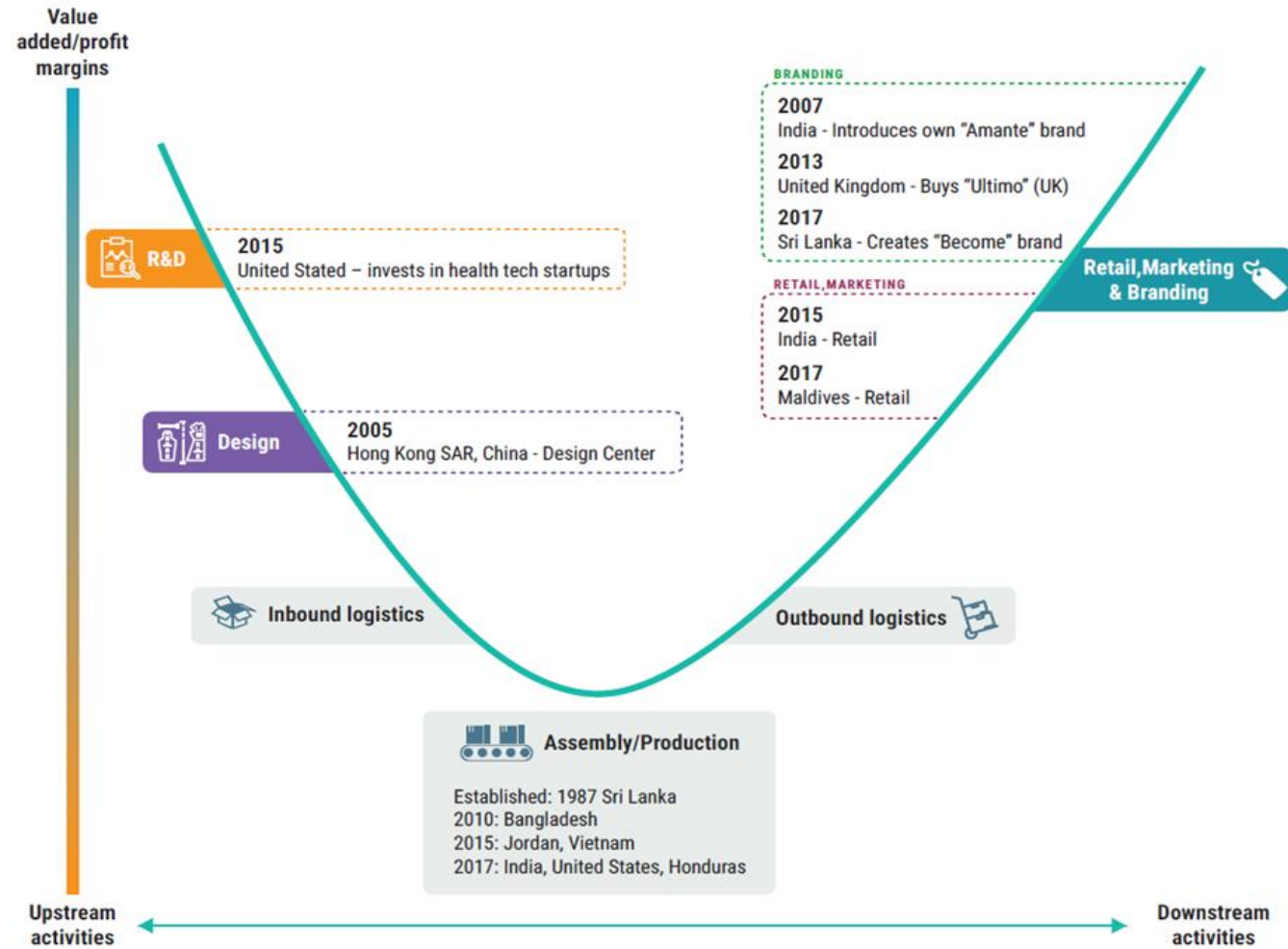


Twitter: @Sanjay\_1818



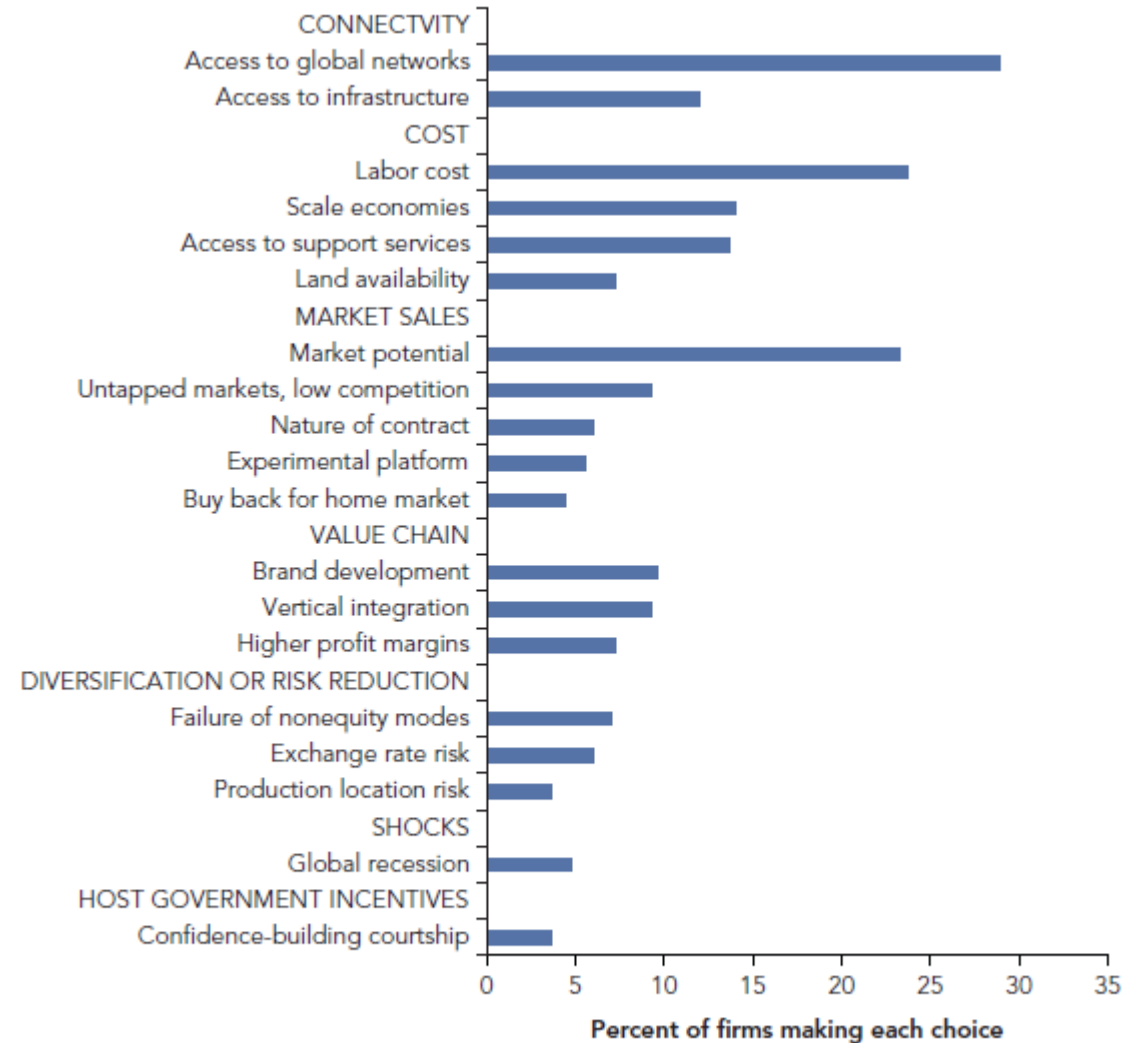
**EXTRA SLIDES**

Benefits of OFDI to emerging market multinationals: How OFDI helped MAS Holdings upgrade along the apparel value chain



# Motivations for investing in South Asia

## Detailed Motivations for Investing in South Asia

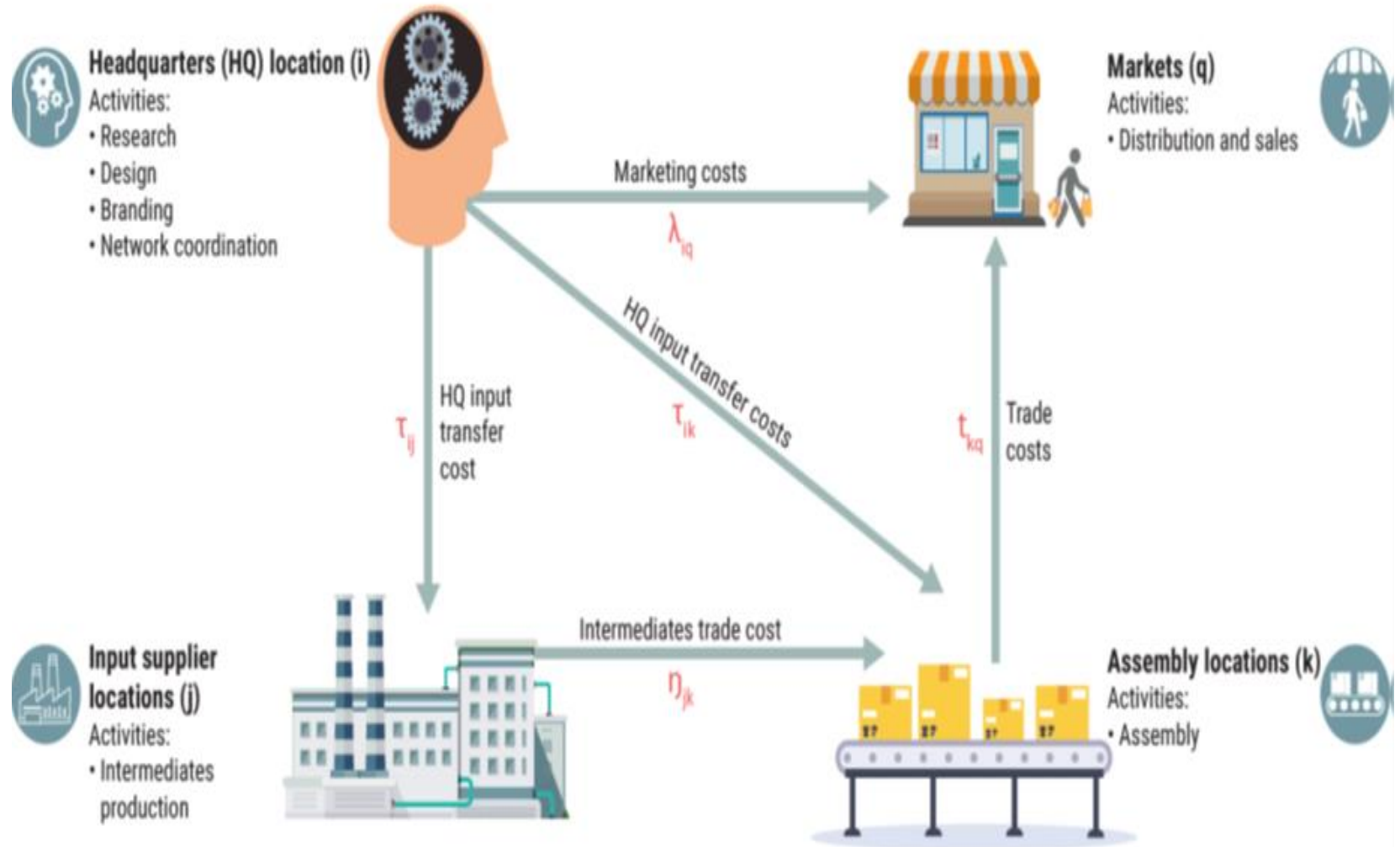


Source: Computation based on the South Asian Regional Engagement and Value Chains Survey.  
Note: Firms, *N*, could make more than one choice. *N* = 267.



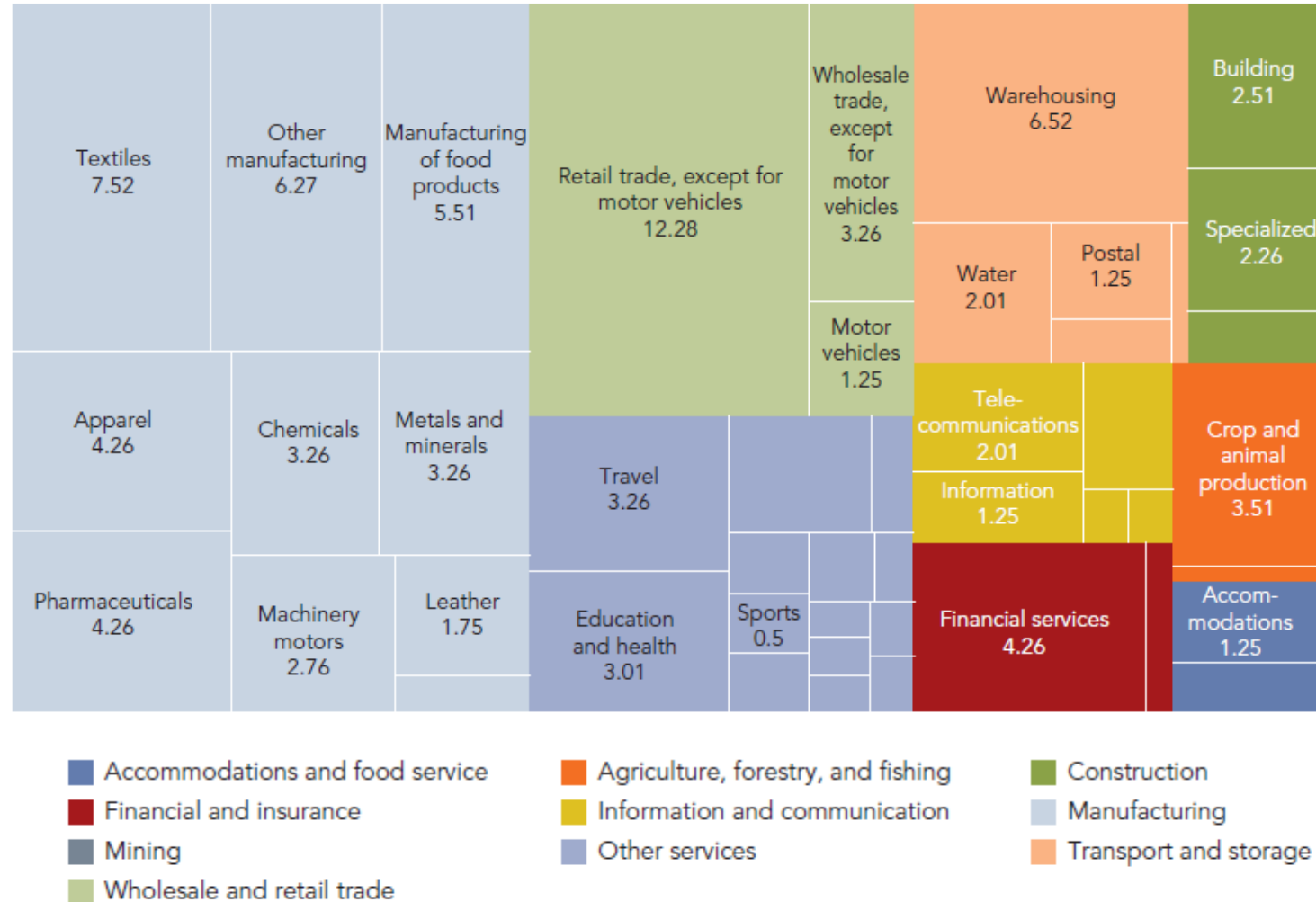
# Value Chain activities, their location and frictions; including ENTRY costs

## Multinational activity location options and frictions



Source: Adapted from Head and Mayer (2019)

# What sectors are investment pioneers from ?

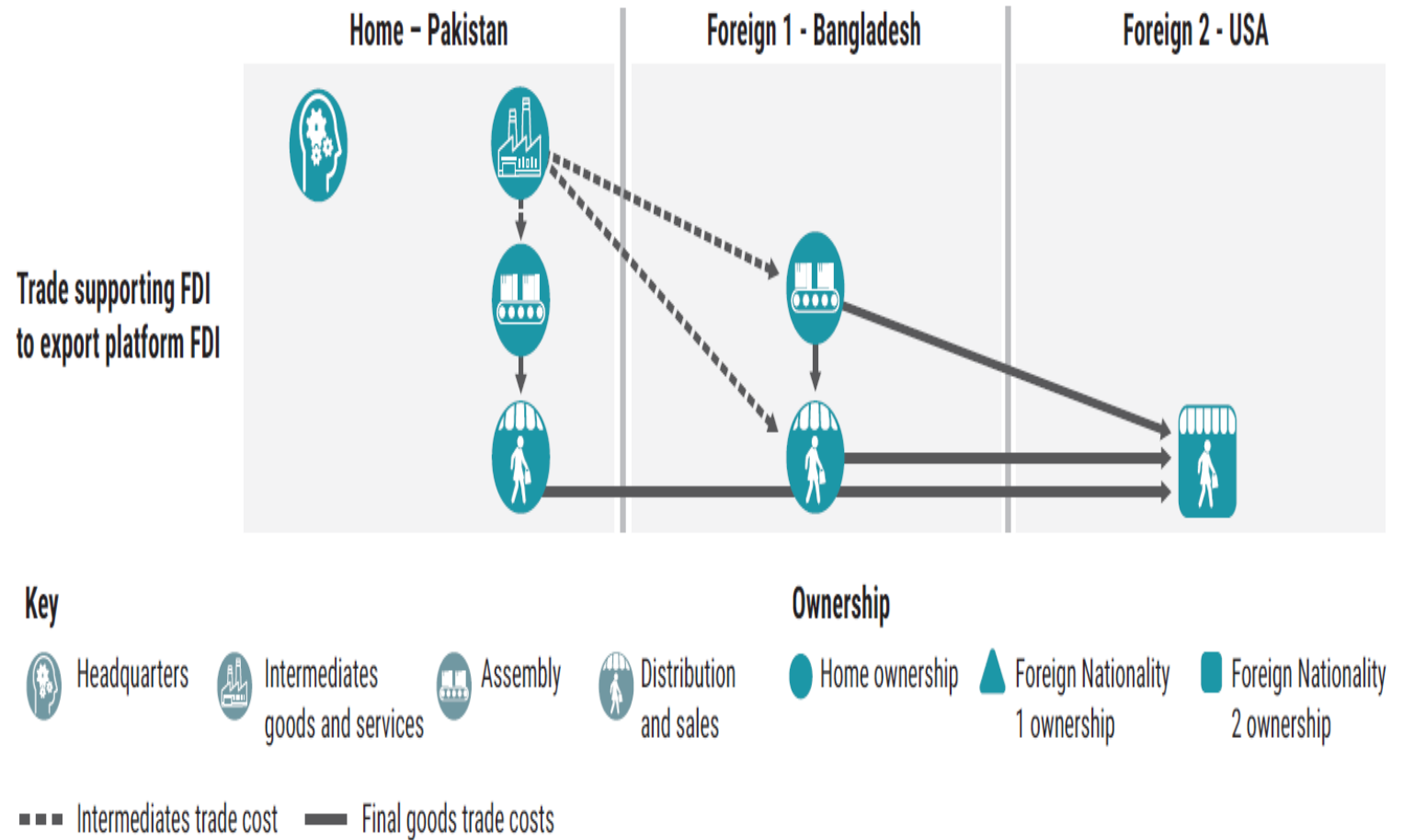


Note: Blank boxes represent sectors with smaller shares of respondent firms.

# Many paths of investment pioneers

Dynamic story from distribution investment to production investment

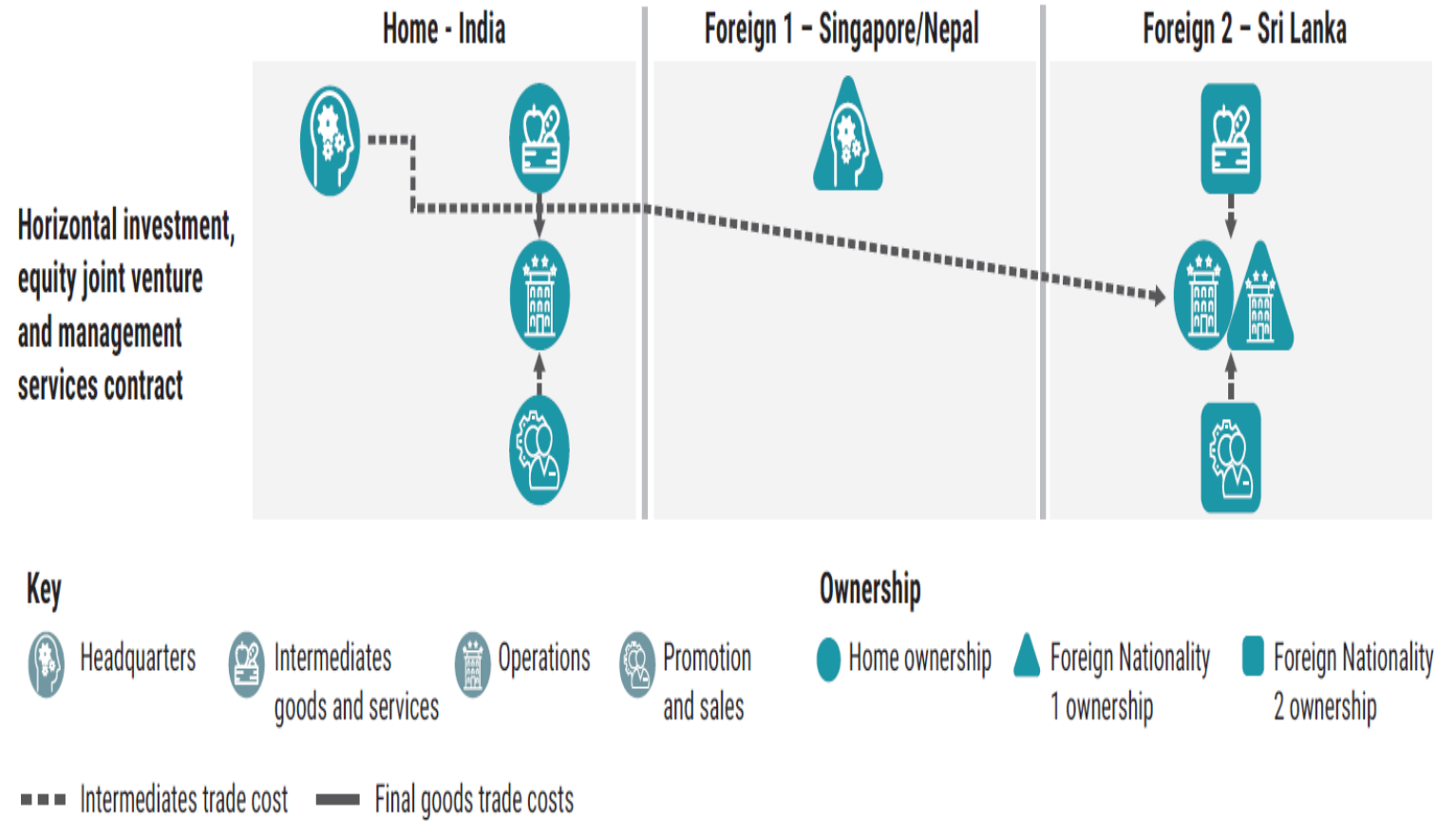
Soorty Enterprises



Note: Input transfers from headquarters to all other activities at home and abroad are not illustrated to avoid clutter. ● in Foreign 1 and Foreign 2 represent OFDI by Home country.

# Management contracts and investment in hotels

Taj Hotels, CG  
Hospitality/Innovation



Note: Intermediates includes food and beverages, recreational activities. Input transfers from headquarters to all other activities at home are not illustrated to avoid clutter.

Management services are provided by Home headquarters to Foreign 2 operations. No management services are provided by headquarters in Foreign 1.

● in Foreign 1 and Foreign 2 represent OFDI by Home country. ▲ In Home and Foreign 2 represent OFDI by Foreign country 1.

## The Bottom Line: Characteristics of Successful Outward Investors

- Many opportunities, many paths in South Asia and beyond
- OFDI is an integral component of international engagement
- South Asia investment regimes increasingly improving but outward foreign investment regimes very constraining
- Knowledge connectivity, networks and bilateral trust is low, and polarized in South Asia
- Regional pioneers tend to be big, high productivity firms, with internal surplus funds and invest near by
- They also tend to have a well-connected founder/CEO with risk appetite. They invest where there are low bilateral communication costs
- Investment tends to be incremental, with knowledge gained in previous cross-border engagements leading to bigger commitments
- Interventions in knowledge connectivity and investment regime liberalization would expand opportunities for more South Asian firms