PRIVATE FOREIGN CAPITAL INFLOWS TO RURAL INDIA IN THE PRE-LIBERALISATION PERIOD

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Abstract : The study traces the private foreign capital flows in the pre liberalization period by looking at the total inflows during five distinct phases therein. The political economy during each of the phases has a bearing on the extent of inflows. It may be noted that though the policy framework does not specifically make references to attract private foreign capital towards the rural sector, there seems to be a nexus between the five year plans of the government or balance of payment position and encouragement of foreign companies to set up operations in rural areas. This paper evaluates the performance of three such companies, namely, Nestle, Ingersol Rand and Escorts (a joint venture) in terms of timing and location of setting up operations; expansion and product launches for the pre-liberalisation period. The analysis indicates that there exists a strong nexus between the performance of these companies and policy framework adopted by the political economy during each phase.

***IndexTerms* – Private foreign capital inflows, Rural India, Foreign companies in the pre-liberalisation period**

I. INTRODUCTION

The relationship of the Indian government with foreign capital can best be described as tumultuous. The first Prime Minister Jawaharlal Nehru did acknowledge the fact that foreign capital, which comes along with industrial, scientific and technical know-how is required for development. Yet it remained highly regulated. While imports of capital equipments were buoyant, private foreign capital inflows in general were not encouraged evenly at all times in post independence (Dhar, 1988). The Feldman-Mahalanobis (Mitra, 1957) Model which formed the theoretical framework for the second five year plan in India required huge investment in capital goods and hence necessitated large imports of capital equipment during this period. Subsequently, since 1960-61, there were maintenance imports (Misra & Puri, 2015) which became essential.

Within two years of its implementation, the Feldman-Mahalanobis Model led to some grave problems. The Indian economy did not have enough savings and this posed to be a major limitation. Neither the agriculture sector nor the industrial sector could generate the required savings rate. The Second Plan was financed through taxes, deficit financing and external assistance. External assistance was a whopping 80% higher than that envisaged in the Plan. A staggering Rs. 1435 crores as against Rs. 800 crores envisaged in the plan was financed through external assistance. In the debate on the choice between private foreign capital and debt, the Indian planners obviously chose the latter over the former during the said time period.

Today, in the post liberalisation period, particularly in the last decade, there is a profound interest in India by multinational corporations (MNCs) as well as Small and Medium Size Enterprises (SMEs), given the Indian government's all out efforts to attract FDI. The interest in India also stems from its attractiveness as a low-cost production location and the large potential local demand that the Indian populace offers. Moreover, Indian companies too are turning global and are looking for greener pastures in foreign markets.

Notwithstanding the fact that private foreign capital was not encouraged during the post independence period, there are some instances of foreign companies being set up in India. It is also noticed that several of these companies were set up to encourage development of the rural economy directly or indirectly. It would be interesting to understand and analyse the policies towards private foreign capital inflows in the 1947-91 period and look into the performance of a few foreign companies that were set up in the same time period and draw conclusions about the policy directions.

II. Review of Literature

Indian policy makers have adopted a regulatory framework of private foreign capital in India since Independence (Dhar, 1988). The regulation has been effected through five year plans, Industrial Policy Resolutions, other legal measures such as FERA, MRTP etc. Surprisingly the private foreign capital that drew scepticism seems the antidote to development issues. Government policies in the past have had various impacts and hence the future policies must tread carefully (Athreye, 2001). Despite the restrictive regime in India, foreign companies have found their way in. Thereafter, with liberalisation, they have been welcomed. A positive relationship was found between the growing number of foreign companies and productive efficiency of Indian industries. (Majumdar, 2005). An analysis of the FDI inflows in the pre and post liberalisation period shows that FDI has acted as a catalyst for domestic industrial and economic development. (Akhtar, 2013). The foreign investment regime started off with being restrictive and since the 1990's, it has been open. The opening out of the economy has now been attracting SMEs. There are various pitfalls, but they can be avoided and successfully overcome. (Belhoste, 2008). In the post liberalisation period there have been many success stories. But, in the pre-liberalisation period, large number of Indian companies benefitted from the restrictive regime. (Nagaraj, 2003)

III. Objectives of the Paper

1. To study and interpret the policy and pattern of private foreign capital in India during the pre-liberalisation period.
2. To examine and evaluate the performance a few foreign companies set up to promote the rural economy during the aforesaid period.
3. To identify if there existed a nexus between the policy on private foreign capital and performance of foreign companies.

IV. Policy on Private Foreign Capital/FDI Inflows: 1947-91

FDI is a relatively newer term in India, used since the early 1990s. Foreign capital inflows were termed as foreign private capital and the same included both foreign finance and foreign technology. As noted earlier, the policy regulation in India with respect to private foreign capital has been a little disorderly. It is popular knowledge that Indian policy makers placed excessive restrictions on private foreign capital. However, a closer look will suggest that the same was welcomed sporadically, or rather guided by the need to make short term adjustments in the balance of payments. The report of the Industrial Licensing Policy Inquiry Committee (ILPIC) suggested that corrections in the BOP have not been made through long term measures such as import substitution or self reliance, but through "Short-term balance of payments mitigation" (Ministry of Industrial Development Internal Trade & Company Affairs, 1969, p. 4). The ILPIC further noted that "The craze for foreign collaborations resulting from Government's policy of favouring those applicants for licenses who could secure foreign collaborations with equity participation and foreign credits made it difficult in some cases for genuine Indian parties to establish themselves".

It would be pertinent to examine the reasons why foreign investment was encouraged, albeit, in fits and starts. The tacit objective of welcoming foreign investment is to supplement domestic savings. This is evident during the first phase, 1947-57. The other objective has been to bring about adjustments in the BOP. Joint ventures and foreign collaborations were encouraged to enable the usage and application of technology. These objectives became obvious during the second phase i.e. 1958-65.

The movement of foreign private capital inflows in India can be classified into four phases of regulation or the lack of it.

The first phase that is the decade of 1947-57 saw a regulated, mildly encouraging, but highly ambiguous policy with respect to private foreign capital. The British companies, which constituted the major part of the foreign investment in India had concerns regarding a takeover or nationalisation by the Indian government, uncertainty with regard to repatriation of profits and had no assurances of the path they could adopt for expansion or diversification. It was only when the then Prime Minister Jawaharlal Nehru made a statement in the Parliament on April 6, 1949 that there was some clarity. He assured that the foreign companies that they would be treated no differently than their Indian counterparts, that the regulations regarding further investment would be mutually beneficial, that the policy with respect to repatriation of profits would remain unchanged and that a takeover would fetch a fair price to the foreign company.

The government initiatives enabled the setting up of Burmah Oil Company and SOCONY-Vacuum (now ExxonMobil) as also agreements for investments in the steel sector that were being negotiated. The existing foreign companies like Hindustan Lever, Dunlop, Guest Keen Williams, Philips India, Imperial Tobacco (now known as ITC Ltd) offered their shares to Indians not so much on account of any pressure from the government but more as they wanted local assistance for securing clearances for the multiple regulations placed in the industrial policy.

The second survey of India's Foreign Liabilities and Assets conducted by the Reserve Bank of India in 1953 showed that foreign business investments in India increased by about Rs.130 crores between June 1949 and December 1953. (Dhar, 1988). .A lot of these inflows were on account of the oil companies that were being beckoned into India. In 1954, it was reported that there had actually been a disinvestment since 1945 of about Rs. 35 crores. (Stated by the Finance Minister C.D. Deshmukh in reply to the Demand for Grants, 1954, p. 14). The same can be seen from Table 4.1 below.

Table 4.1: Private Foreign Investments in India (1948-58)

(Figures in Crores of Rupees)

As at the end of	Total outstanding	Increase over the previous period
June 1948	264.6	-
December 1953	397.1	132.5
December 1955	442.4	45.3
December 1956	478.3	35.9
December 1957	532.0	53.7
December 1958	562.3	30.7

Source: RBI Bulletin, April 1966, pp 374-76; January 1967, P 55

The next phase (1958-65) was a period of foreign exchange crisis on account of excessive borrowing and reduction in direct capital inflows. The Industrial Policy Resolution 1956 opened out 7 of the 17 industries that were under the realm of the government, which by and large benefitted foreign companies. The beneficiaries/ foreign entrants included L&T, ACC, English Electric Co Ltd, Siemens Nestle etc. There was clearly a liberalisation policy in place what with the government seeking aid from the World Bank and USAID. Additionally, the Birla Mission went abroad in 1957 with the specific objective of encouraging foreign firms to invest in Indian industry, and discovered that Indian and foreign capital had complementary i n t e r e s t s to work together. The change in Government policy towards foreign capital followed as a matter of course (Ghosh, 2015).

The Washington Consensus is a term that was used since the 1980s to indicate the hegemony and tacit directives laid down by the IMF and WB combine when they offered any assistance to a country. Two committees were set up in this time period, one to facilitate inflow of foreign capital and another to facilitate foreign collaborations. The setting up of both these committees was an indication of the intervention or tacit directives from the WB that India had sought aid from at that point. These two committees were the Industries Procedures Development Committee in 1962 which helped to facilitate inflow of foreign capital and enable smoother processes for the setting of foreign companies; and, the Mudaliar Committee Report on Foreign Collaboration, 1967 which provided a boost to the foreign technology and collaborations in areas other than those envisaged in the plan as high priority areas. (India, Ministry of Industrial Development and Company Affairs, Report of the Committee on Foreign Collaboration, 1967).The Committee also sought to ease the procedural delays. It paved the way for setting up the Foreign Investment Board in 1969.

Foreign capital poured in during the 1960s (Athreye & Kapur, 2001). The new foreign capital was directed towards manufacturing in areas that were technology driven. In order to avoid a direct confrontation with the Indian companies that were raising their voices through forums like FICCI, the government circumvented it and preferred to take the collaboration route. With the joint participation of the Indian companies, the picture seemed as if the government was less in favour of foreign companies**.** Table 4.2 summarises the increase in the private capital inflows in the second phase.

Table 4.2: Private Foreign Investments in India (1959-65)

(Figures in Crores of Rupees)

As at the end of	Total outstanding	Increase over the previous period
June 1959	**582.8**	**20.3**
December 1960	**634.7**	**51.0**
December 1961	**679.8**	**45.1**
December 1962	**733.3**	**53.5**
December 1963	**786.9**	**53.6**
December 1964	**856.2**	**69.3**
December 1965	**935.8**	**79.6**

Source: RBI Bulletin, April 1966, pp 374-76; January 1967, P 55

The third phase was the most stringent after the then Prime Minister Mrs. Indira Gandhi's government took some sweeping decisions. As against popular belief that Nehruvian era was socialist in its outlook, it seems that the next time period was much more socialist in its approach. Nationalisation of coal mines was followed by nationalisation of banks, the draconian MRTP (1969) and FERA (1974) signaling an era of hostility towards the foreign companies. The FERA provision that the foreign companies should dilute their equity holdings to 40 percent (except in case of technology based companies) to be treated at par with Indian ones was a clear indication of the partisan policies. Some companies diluted their share to 70 percent under various pressures from the government, often not overtly exerted.

The lack of adequate growth in the 1980s ushered in the fourth phase of opening up of the economy. In the mid 1980s the government headed by the then Prime Minister Rajiv Gandhi and the Finance minister V.P. Singh took two initiatives; firstly, the creation of the Long Term Fiscal Policy and secondly, the setting up of the Abid Hussain Committee. These two initiatives were the harbingers of a new liberalised environment. However, foreign investment projects were still very vulnerable to bureaucratic discretion (Athreye & Kapur, 2001). The various policies promulgated for promotion of 100 percent EOUs was also a pointer in the same direction.

The last and fifth phase is that since 1991 when on account of the BOP Crisis India had to take recourse in a IMF bailout package and the same necessitated the announcement of the New Economic Policy, which completely changed the face of the Indian economy from an inward looking one to a much more open economy. Also, the direction of the reforms has ever since remained the same, with no scope for a roll back.

Table 4.3 gives a summary of the private foreign capital inflows over the period 1948-1992. The data shows heavy reliance on foreign debt as against direct foreign investment.

Table 4.3: Stock of Private Foreign Capital in the Indian Corporate Sector

Particulars/Year	**1948**	**1960**	**1970**	**1980**	**1987**	**1992**
Long-term investment (Rs Cr) *of which*	5.8	5.7	16.4	22.19	133.6	536.5
Direct Investment (% share in total)	2.6	5.0 (89)	7.4 (44.8)	9.3 (42.1)	17.4 (13.0)	38.4 (7.2)
Portfolio Investment (% share in total)	n/a	0.5 (9.0)	0.9 (5.7)	1.2 (5.5)	4.6 (3.4)	14.8 (2.8)
Foreign Debt	n/a	0.1	8.1 (49.5)	(52.4)	111.0	483.3 (90)

Source: Dhar, 1988

V. Foreign Companies in India to Encourage the Rural Economy: Pre liberalization Period

In the post independence era, some of the companies set up under the British Raj, continued to operate. The fate of these companies and those set up after independence was probably linked to the policy flip flop. It had not been a smooth sail for some foreign companies clearly. The cases of Coca Cola and IBM are one of the more prominent, wherein they exited in late 1970s due to differences with the then government led by Morarji Desai and the draconian Foreign Exchange Regulations Act (FERA) that was in force. Other Multinational companies such as Hindustan Lever (Division of Unilever), Nestle, OTIS, etc have their presence in India till date. Some of these were set up to encourage the rural economy. Also, some of the Indian companies were encouraged to form joint ventures through foreign collaboration and produce capital equipment and agricultural machinery.

It will be interesting to see if the performance of the companies followed the policy framework. The researchers have tried to examine three foreign companies set up to as a case in point to see if there exists a link between policy framework and their performance. Financial performance is generally assessed using revenue or sales figures, profitability and/or return on capital employed. On account of non availability of consistent financial data for the time period 1947-1991, proxies such as setting up of operations, expansion in business and product launch have been used.

1. NESTLE INDIA

Nestle India is a subsidiary of Nestle S.A. of Switzerland. It was set up in 1956 in India and hence coincided with the second phase wherein private foreign capital was encouraged. Nestle India started its operations in the year 1961 from Moga, Punjab in response to the Government’s encouragement to produce locally and develop the milk economy in the rural sector. Nestle encouraged the production of milk in the region by setting up milk collection centres and paid fair prices. NESTLÉ's Agricultural Services was set up to educate, advise and help the farmer in a variety of aspects from increasing the milk yield of their cows through improved dairy farming methods, to irrigation, scientific crop management practices and helping with the procurement of bank loans ("Nestle India Ltd. (Nestleind) - Company History”, 2018). This move had enabled an increase in employment, directly and indirectly in the region.

Later in 1965 Nestle India set up its second unit at Choladi in Tamil Nadu. There seems to be a lull with respect to expansion and a long gap in the setting up of the next unit which was in the year 1989 at Nanjangud, Karnataka. With the policy detraction towards private foreign capital inflows and the promulgation of FERA, expansion of foreign companies was discouraged. The setting up of the Nanjangud unit coincides with the reversal of the policy during the phase of liberalisation undertaken by the Rajiv Gandhi government. Thus, there is a clear nexus between setting up of the company and its expansion with the policy framework on private foreign capital.

An examination of the products launched by the company over time too reiterates the path adopted by the policy framework. Nestle India initially launched Milk Maid , the condensed milk, followed by tea at the Choladi factory, followed by instant coffee in its Nanjangud outlet. Since 1991, nestle has set up factories in Haryana, Goa and Uttrakhand launching various products like Maggi, Milkybar, Kit Kat, Bar-one, etc.

2. INGERSOLL RAND

This is a company which existed in the pre 1947 period. It was renamed as Ingersoll-Rand (India) Pvt. Ltd. after the Companies Act, 1956 came into force as the Act require Indianisation. The Company Manufacture air and gas compressors, vacuum pumps, blast-hole drills, water well drills, etc. Ingersoll Rand was a trading firm, but subsequently in 1965 ventured into manufacturing activities at Naroda, Ahmedabad in Gujarat (Ingersoll-Rand (India) Ltd. Company History and Annual Growth Details, 2018). This is an indication of the fact that the government was encouraging the foreign companies to manufacture in India rather than trade as noted above during the second phase. The blast hole drills were used in iron ore mining, therefore forming a part of the equipment used in the primary sector.

The company started with an initial capitalisation of Rs. 1,00,000/- during its inception in 1938.In 1977, the foreign equity holdings were decreased to 74 % through a public issue to Indians. As noted earlier, many foreign companies diluted their foreign equity with the intent to secure local assistance for clearances for the multiple regulations placed in the industrial policy as also under pressure from the FERA regulations. This was in line with the policy direction during the third phase. Again in alignment with the governments selective encouragement of foreign companies in the technology driven areas, in 1978, the company set up operations in Bangalore for the manufacture of down the hole hammer drills, hard held light drills, carset bits, heavy duty blast hole drills and water well drills. In recent years, Ingersoll Rand's has been producing refrigerated transportation solution which addresses a critical issue of large scale waste of perishable farm produce. It is estimated that India currently wastes 35-40% of agricultural produce. A robust farm-to-fork cold chain infrastructure can help reduce farm wastes.

3. ESCORTS (AGENTS) LTD

Escorts (Agents) was set up in 1944 in Lahore, now in Pakistan. This case is a little different from the two cases discussed above, as Escorts is an Indian company. However, it had several joint ventures (form of private foreign capital) at a time when the same was not much heard of. The company produces agriculture machinery such as tractors, construction equipment and railway equipment. The government was encouraging JVs on account of the import substitution policies that it was following.

In 1949, during the time period of the first five year plan, when the country had still not established an out and out hostile attitude towards private foreign capital, Escorts Agricultural Machines, with a franchise from US–based Minneapolis Moline, for marketing tractors, implements, engines & other farm equipment was launched. In the same year yet another franchise was secure with Massey Ferguson tractors for marketing the same in northern India. It may be noted that in 1953, Escorts (Agents) and

Escorts (Agriculture and Machines) merged to form Escorts Agents possibly to take advantage of the government's policy towards production of capital equipment in India. In fact, if one observes the time line of events, Escorts entered a JV with Goetze of Germany in 1954 and a collaboration with Mahle of Germany again to manufacture pistons by 1959.

Yet another JV with URSUS of Poland 1961 saw the setting up of manufacturing base at Faridabad for manufacture of tractors wherein 50% indigenous components were used in the production process. By 1969, Escorts Tractors was set up as a technical and financial joint venture with the global giant Ford Motor Company, USA, to manufacture Ford tractors in India.

Being basically an Indian company, the growth path was different from that observed in the case of Nestle and Ingersol Rand. Escorts signed one JV after another even during the period 1971-84, which is conspicuously absent in the case of full-fledged foreign companies.

As far as new product launches is concerned, Escorts went from producing piston rings to tractors to motorcycles and scooters to telecommunication to the health sector.

VI. Conclusions

The policy document with respect to foreign capital seemed hostile towards inflow of foreign capital in 1948. Assurances by the then PM Jawaharlal Nehru, through a statement in the Parliament to foreign investors didn't help much and as a result the inflow of private foreign capital remained low in the first phase, 1947-57. The IPR of 1948 had sent out a strong negative message to foreign companies by suggesting that as a rule the major ownership and effective control would remain in the hands of Indians and that training of Indian personnel would be encouraged so that they would replace the foreign counterpart. Thus, the Industrial Policy Statement 1948 discouraged the setting up of new companies. There was an improvement in foreign capital flows with the setting up of oil based companies. The IPR 1956, gave a boost to the inflow of private foreign capital when companies like Nestle were set up and the same helped in providing a boost to the rural economy. This buoyancy was curtailed by the stringent FERA era. Finally, the mid 1980s and later the 1990s saw opening up of the economy and the increased presence of foreign companies.

The flip flop policy on private capital inflows has greatly influenced the performance of foreign companies/Joint ventures as is evident from the three companies studied. A performance analysis of the three companies indicates that they were set up/incorporated when the policy welcomed foreign companies with a view to provide an impetus to the rural sector. They were also encouraged to supplement the domestic investment or to correct a disequilibrium in the BOP. During these phases, that is, phases 2, 4 and 5 the companies expanded their operational bases as well as launched new products. This did enable the rural economy to become more robust. However, when the policy framework was hostile towards private foreign capital, as was the case in phase 3, the expansion plans were curtailed.

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