India's Investment Environment – April 2008

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I. Introduction

The Government of India is considering the further liberalisation of foreign direct investment (FDI) norms for some sectors, such as small-scale industries (SSIs), real estate and broadcasting. Certain changes regarding divestments are also under consideration. However, the Government is not considering any change in FDI regulations in the retail sector. In the case of defence manufacturing by the private sector, the private players seem to be divided on the issue of 26 percent FDI cap which was imposed through the Department of Industrial Policy and Promotion (DIPP) Press Note No. 4 of 2001. Foreign investors are campaigning for increasing the FDI cap to 49 percent.

The Ministry of Defence, which plays a major role in granting waivers from the FDI cap, has imposed a condition that the waiver can only be given to companies bringing significant technology into India. This provides discretionary powers to the Ministry to waive the constraint imposed by the cap on a case-to-case basis. The private Indian companies, which include large and influential players like L&T and Kirloskars, are opposing to the enhancement of FDI limits beyond 26 percent by the Ministry of Defence.

II. Expected Changes in FDI Rules

The following changes in FDI rules are expected in the near future:

i Divestments clause: Expected to be removed
The Government is considering the complete waiver of the mandatory divestments clause in key sectors, like food processing and chemicals for all companies that have agreed to undertake mandatory divestment. At present, the mandatory divestment clause is not applicable to new clearances. However, companies that had agreed to mandatory divestment have not been given a blanket waiver. The approvals are being given only on a case-to-case basis. If this clause is cleared, foreign investors can hold 100 percent in arms without having to dilute their stake in favour of Indian stakeholders.

ii Small Scale Industries (SSIs): Easier FDI norms expected
Another decision being made by the Government relates to allowing FDI into SSI sector through the automatic route instead of the existing Foreign Investment Promotion Board (FIPB) route that requires prior Government approval. If implemented, the Reserve Bank of India (RBI) needs to be informed of such investments only after they have been made.

The Government is also considering the removal of the current 24 percent FDI cap on all companies in the SSI sector. Such units might be allowed to raise foreign equity in accordance with the individual sectoral caps. At present, foreign equity participation exceeding 24 percent in the SSI sector or in production by a non SSI unit of an item reserved for the small sector requires an industrial licence with a minimum export obligation of 50 percent production.

iii Real estate companies may get relief

Real estate companies developing various projects simultaneously are expected to get a waiver from FDI norms for some of their projects if a majority of projects comply with FDI conditions. At present, to bring in FDI, the companies are constrained by a three-year lock in period and the requirement for a minimum development of ten hectares. Under the expected waiver, the companies that take up expansion projects would be eligible to get FDI even if they do not comply with the required conditions separately on their own.

The Government is also considering granting a waiver of the requirement of a three-year lock in period for pre-initial public offer (IPO) investment by overseas entities. It is being considered that such investment can be treated as portfolio investment rather than FDI.

iv Telecommunications

The FDI cap for the cable TV services and Head-end in the Sky (HITS) satellite based system of TV signal distribution via cable may be revised to 74 percent from 49 percent. The move would eventually lead to greater competition in telecommunication, particularly when convergence of telecast distribution, telecom and broadband becomes a reality.

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