# India's Investment Environment – April 2009

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## I. Introduction

Despite the global financial crisis and its impact on FDI into the country, India has fixed a target of $30 billion of FDI for the financial year 2009-10, an increase of 9 percent over $ 27.5 billion for the last fiscal. The overall outlook for FDI flows into India is expected to be positive and total FDI can touch the $40 billion mark if we take into account the profits of foreign firms reinvesting in India. Foreign investors are increasingly looking at India as an investment destination. Foreign investors, particularly Japanese, have been increasingly flexible in their approach to business relationships with their Indian counterparts. They have understood the advantage of having a local partner who can address issues such as government liaison, labour and compliance while going on with the job of manufacturing.

The government has been continuously making serious efforts to simplify the FDI policy to provide enabling business environment in India.

## II. Expected changes in FDI rules

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

**(i) Government may allow 49 percent FDI in domestic airlines by their foreign counterparts**

The government is considering a proposal to allow foreign airlines to pick up equity stakes up to 49 percent in domestic carriers through the automatic route. This implies foreign airlines would not have to take prior approval from the Foreign Investment Promotion Board (FIPB) before investing in domestic carriers. The change in FDI rules, if approved, will not only help the 15 scheduled airlines like Kingfisher and Air India but also the 98 non-scheduled operators.

At present, foreign airlines are not allowed to hold a direct or indirect stake in domestic airlines. However, foreign companies other than airlines are allowed to hold up to 49 percent stake in domestic carriers. In the past, the government did not allow FDI from foreign airlines as it felt that this would cause harm to the domestic aviation sector. Cash rich carriers such as Singapore Airlines have evinced interest in owning stakes in local airlines, but have been prevented by FDI rules.

**(ii) Foreign bank liberalisation policy kept on hold**

The second phase of liberalisation of the operation of foreign banks in India was to be initiated from April 2009 but the liberalisation policy has been held back by RBI due to the current global financial meltdown. Now the review of the policy will be taken up after due consultation with the stakeholders once there is greater clarity regarding stability, recovery of the global financial system etc.

In 2005, the RBI divided the roadmap to liberalise the operation of foreign banks in the country into two phases, the first phase spanning the period 2005-09 and second phase beginning April 2009, after a review of the experience gained in the first phase.

**(iii) Government plans to bring out another clarification on Press Notes 2, 3 and 4 of 2009**
The government is planning to issue yet another clarification regarding the exclusion of banks from the purview of its recently revised FDI norms (through Press notes 2, 3 and 4 of 2009) to avoid classifying a few private sector banks as foreign entities. RBI had recently pointed out to the government that under the revised FDI norms the Indian private sector banks such as ICICI bank, HDFC bank, ING Vysya and Development Credit bank would cease to be counted as Indian owned banks as the foreign investment, according to new FDI guidelines, in each of these banks exceeds 50 percent. The RBI, backed by Finance Ministry, has sought a review of the new guidelines.

The government is expected to address the clarification on certain key issues. These issues include treatment of FDI in the banking sector, shielding FDI-prohibited sectors such as multi brand retail, agriculture and gambling from foreign capital and treatment of investments made prior to introduction of the new FDI calculation norms.

The government will also review the guidelines on investment by foreign institutional investors (FIIs) in sectors where ceilings have been prescribed on foreign holdings and specific government clearance is required for bringing in foreign investment. The government is planning to exempt FIIs from clearance from the government prior to purchasing shares on the stock market.

The above mentioned Press notes were issued to indirectly increase investment by skirting sectoral caps. But, instead of serving as road map for boosting investment, the press notes created confusion. Subject to wide ranging interpretations, they increased the government's regulatory powers and arguably opened up restricted/sensitive sectors to FDI.

## III. News & Views

**(i) Allowing FDI in organised retail can boost business**
It is being debated whether allowing FDI in organised retail can enhance foreign economic activity in the Indian economy. At present the retail sector is tightly controlled in regard to FDI flows which are allowed only for the wholesale cash and carry and single brand firms. The primary bone of contention between advocates and opponents of FDI in retail has been regarding the fate of domestic retailers after the entry of overseas players.

It has been stressed that entry of foreign firms into organised retail will not only bring in investible funds but also global expertise and knowledge, especially in the case of back-end and supply chain management, an area that lends itself to sufficient cost control in India. It is also being argued that given the size of the Indian market and the convenience provided by domestic retailers to their customers, the threat of an organised retail takeover does not appear likely in the near future. Moreover, banning FDI in retail may not completely eliminate foreign competition. Foreign players may still gain access to India's consumers through licensing and franchisees -- routes that were used prior to FDI permits.

Contrary to this view, some political party manifestoes in the ongoing general elections emphasise that the existing windows for retail FDI should also be done away with though this may not affect those who have already entered the market.

**(ii) FDI funds turned two way**
Not only is India attracting inward flows of FDI as a consequence of its liberalised investment climate and a perceived growth opportunity, capital is also flowing out of the country. This two way

flow of FDI has radically altered the age old impression of domestic stakeholders that FDI means only a unidirectional flow of capital that is inwards. This also reflects the growing competitiveness among Indian corporations and their global ambition.

It is also being argued foreign investment by Indian corporations is not only driven by commercial logic but also by the perceived inadequacy of natural resources within the country and the policy roadblocks that hinder their exploitation. Lack of transparency and absence of long term policies deter the free flow of investment.

To be sure, most of the outflow of FDI from the country has been in the manufacturing and energy sectors. However now, FDI from India is beginning to flow into agriculture too. To begin with, a small number of Indian corporations are investing in oil palm plantations abroad. It is being debated that this is being done to de-risk its refining operations from the possible vagaries of supplies in the future. The perception of the domestic vegetable oil industry is that India is very unlikely to achieve self-sufficiency in vegetable oils anytime soon and would continue to be a major importer for years to come. There is a perception that the Indian government's policy has failed to boost indigenous output to the extent necessary for keeping pace with growth in demand.

**(iv) US seeks transparency in modified FDI norms for ISPs in India**

Expressing concern over what it calls barriers for American telecom companies in India, the US has sought transparency in the procedure for modifying FDI norms for Internet Service Providers (ISPs) in India. The US urges India to afford greater regulatory certainty to companies already operating in India, and to comply with its GATS commitments to make such measures publicly available.

India previously had allowed 100 percent foreign ownership of ISPs. In 2007, Telecom Regulatory Authority of India (TRAI) introduced a ceiling on percentage ownership of ISPs and made it equivalent to that for international and domestic long distance operators. TRAI also suggested that companies be given a grace period to start complying with the new ownership rules. But the grace period has not been formalised by India, and as a result, many companies are uncertain regarding their status in the market. The companies are also uncertain about whether or not they must seek new licences under their new ownership structure.

**(iii) Companies cash in on new FDI norms**

Faced with shortage of funds, Indian companies such as *Pantaloon Retail* and *UTV* have started taking advantage of the positive change in the new FDI guidelines made effective from February 2009. As per the new guidelines, any company which has Indians holding 50 percent equity stake in an entity and has the power to appoint a majority of its directors can raise foreign funds and the same will not amount to FDI for subsidiaries of such companies. The extent to which indirect foreign investment can be brought in has been effectively raised with the new norms.

*Pantaloon Retail* has decided to hive off its fashion and retail divisions to its wholly foreign owned subsidiaries to take advantage of these new FDI norms. Similarly, UTV has also decided to invest up to 49 percent in an Indian special purpose vehicle in which Ronne Screwvala, founder promoter and his affiliates would own 51 percent. This special purpose vehicle would own and control the business news channel *UTVi*.

*Disclaimer: This information has been collected through secondary research and CUTS C-CIER is not responsible for any errors in the same.*