FDI in India

Policy Update April 2010

I. Introduction

India is expected to continue to witness a surge in FDI inflows, given its significant growth even during the global recession and its acceleration thereafter. The Indian growth rate thus continues to maintain its healthy lead over that in developed countries. FDI flows are expected also because India is under-invested and the government is committed to provide a very hospitable environment for foreign investments in the years to come.

II. Expected changes in FDI rules

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

1. New Norm to reverse FDI Leeway

The Government is planning to shut the route allowing firms with up to 49% FDI to make downstream investments in sectors where FDI is prohibited such as multi-brand retail, agriculture, lottery and atomic energy. This is despite such firms being treated as domestic companies and their downstream investments as domestic investment by last year's controversial norms for FDI.

It is being argued that the government's decision might also have been prompted by the reduced dependence of Indian corporate groups on foreign capital for their new ventures, given the economic recovery. The government feels that given the changed scenario, allowing FDI through the backdoor in these sensitive sectors could be a risk that outweighs the benefit of any additional investment it could lead to.
http://www.financialexpress.com/news/new-norm-to-reverse-fdi-leeway/601573/

2. Defence Ministry not willing to raise FDI cap in defence production

The Ministry of Defence plans to oppose a proposal from the Ministry of Commerce and industry to allow foreign defence corporations to establish fully-owned defence units in India. The new Consolidated FDI policy, effective from April 1, limits FDI in defence units to 26 per cent. But the DIPP is in favour of raising this limit.

The Defence Ministry apprehends that raising the FDI cap significantly would seriously damage India's nascent defence industry, particularly the defence public sector undertakings.

The R&D-oriented private sector companies are apprehensive that global majors will use their Indian subsidiaries to get the Defence Ministry to fund the development of

weapons systems under the "Make" category of the Defence Procurement Policy of 2008 (DPP-2008).
The DPP-2008 allows any Indian company -- and a 100 per cent Indian subsidiary of a global major would be eligible for this -- to receive funding from the MoD for developing defence platforms under the 'make' category.
http://business.rediff.com/report/2010/apr/12/defence-ministry-opposes-hike-in-fdi-limit.htm

3. Government Plans Discussion on Relaxing FDI Norms

The government would soon be initiating discussion on relaxing FDI restrictions in sectors ranging from defence to agriculture and even retail. The government will come out with six discussion papers on overseas investment norms.

The discussion papers would deal with sectors such as retail, defence, pharmaceuticals and agriculture and will be put in the public domain for comments. On pharmaceuticals, there is a demand to review the policy, so that Indian companies do not end up being purchased by outsiders. India allows 100 percent FDI in drugs and pharmaceuticals.
http://www.financialexpress.com/news/fdi-in-retail-sector-likely-to-be-liberalised/611543/2

4. New FDI norms could queer foreign VC funds'

Foreign venture capital funds will find it more difficult to invest in venture funds here with the government changing the FDI rules. The new rules say foreign funds will now require prior approval for investment in Indian venture funds and they cannot invest in unregistered trusts.

It has been perceived that the move is driven by the government's efforts to curb money-laundering through trusts that are not as regulated as companies. However the move could dampen foreign investments coming into India.

Foreign money coming in through the venture capital route has been under the regulatory scanner since 2007 when there was a surge in investments by these entities into real estate. Both the government and regulators put in place several measures such as restricting tax benefits to select sectors and tightening registration procedures to regulate flow of funds from these entities.

According to the new rules, foreign funds will now require prior approval for investment in Indian venture funds and they cannot invest in unregistered trusts.

Till now, a SEBI registered foreign venture capital investor was allowed to invest under the automatic route in a domestic venture capital fund registered with SEBI. .
http://economictimes.indiatimes.com/news/economy/policy/New-FDI-norms-could-queer-foreign-VC-funds-India-investment-plan/articleshow/5780113.cms

5. Government reluctant to change FDI policy in regard to banks

The Government has indicated its reluctance to change the new FDI policy regarding the treatment of ownership and control in private banks. Press Notes 2, 3 and 4 of the DIPP says that for an entity to be treated as Indian, it should have less than 50 percent foreign investment, including foreign currency convertible bonds, American and Global Depository Receipts as well as convertible preference shares.

The affected private banks include HDFC Bank, ICICI Bank, Development Credit Bank, Federal Bank, Yes Bank, ING Vysya and IndusInd Bank. They are also worried that this rule could adversely impact new investments in their subsidiaries in sectors such as insurance, where there is an FDI limit of 26 percent. This is because these rules could treat the entire capital infusion by the parent companies as inflows from foreign entities without considering the Indian shareholders' holdings, thereby causing it to breach the FDI cap.
http://www.thehindubusinessline.com/2010/04/06/stories/2010040652420700.htm
http://www.business-standard.com/india/storypage.php?autono=390805

6. **Government to keep a tab on FDI on wholesale retail**

The government has decided to keep a close watch on FDI in wholesale retail. At the same time, it is open to revisiting the 25 per cent sales cap by foreign players to their partner companies in the cash-and-carry business. The newly released single FDI policy document mentioned that wholesale trade of goods would be allowed only among companies of the same group. But, such wholesale trade to group companies taken together should not exceed 25 per cent of the total turnover of the wholesale venture and should be meant only for internal use.

According to the current norms, 100 per cent FDI is permitted in the wholesale cash-and-carry trade but it is not allowed in retail selling to consumers directly. Wholesale trading firms, owned by foreign entities, can only sell their merchandise to retailers, hotels, restaurants and the unorganised sector.
http://www.business-standard.com/india/news/govt-to-keep-tabfdi-in-wholesale-retail/391625/

III. News & Views

1. Working Paper Calls for more FDI

A finance ministry working paper "*Policy for India's Services Sector*" has advocated the privatisation of non-strategic profit-making public sector units (PSUs) and raising the foreign investment limit in industries such as retail, health insurance and news channels, among others.

Realising the political difficulty involved in raising the FDI cap in insurance, the paper advocated the opening up of at least the health insurance segment on a priority basis.

The paper also advocated the opening up of multi-brand retail, more liberalised norms for foreign investment in rural banking, rise in foreign investment in news and current affairs television channels to at least 49%, and 26% FDI in railways for its modernization.
http://www.livemint.com/articles/2010/04/08230320/Working-paper-calls-for-more-a.html

2. Misapprehensions Dog Consolidated FDI Policy

The government has come out with a "Consolidated FDI Policy" – a document that supersedes all prior press notes, circulars and clarifications issued in connection with FDI as of March 31, 2010.

It is salutary to have a consolidated document that provides an overview of India's FDI policy. However, the policy document has initiated an ambiguity in India's policy position on pricing of FDI.

Two statements have caused trouble.

The first: *The pricing of the capital instruments should be decided / determined upfront at the time of issue of the instruments.*

The second: *Any other type of instruments (other than instruments referred to in the policy) like warrants, partly paid shares etc. are not considered as capital and cannot be issued to person resident outside India.*

Both these statements are being perceived as uncalled for and ill-considered.
http://www.business-standard.com/india/news/misapprehensions-dog-consolidated-fdi-policy/391600/

3. Japanese retailers want India to remove FDI restrictions

According to Japan Retailers Association (JRA) India is one of the most vibrant and potential markets and over a dozen players from the East Asian nation are willing to invest here, provided the Indian government relaxes foreign direct investment norms in the sector.

Major Japanese players are ready to invest up to US$10mn individually in India – mainly in the multi-branded segment where FDI is currently prohibited. Currently, only around five percent of the Indian retail market of over US$450bn is under the organised segment. Under government rules, FDI of up to 51 percent is allowed in single-brand retailing, while no FDI is allowed in the multi-brand segment.
http://www.hindustantimes.com/Japanese-retailers-want-India-to-remove-FDI-restrictions/Article1-526217.aspx

4. Foreign Investors Prefer Smaller Cities

Small Indian towns score over metros and big cities when it comes to being the destination of choice of foreign investors. Foreign investors prefer smaller Indian towns to big cities for setting up manufacturing facilities, thus establishing linkages with suburban and rural regions of the country, as revealed in a study conducted by National Council of Applied Economic Research (NCAER).

The study, sponsored by the Department of Industrial Policy and Promotion (DIPP) found that about half of the total output, value addition and wages paid in the FDI manufacturing firms originate in small towns. The study also found that the FDI-enabled manufacturing units paid higher wage than the domestic firms.
http://economictimes.indiatimes.com/news/economy/finance/Foreign-investors-prefer-smaller-cities/articleshow/5759107.cms

5. One Year for FDI Warrant Conversion

The government has decided that companies bringing in FDI by issuing warrants will have to convert them into fully paid-up equity within 12 months of the date of issue, or face legal action. Many companies convert warrants into equity when they require or feel like and in some cases, even let them lapse. The recent case is of Ranbaxy: an allotment of 23.83 million warrants issued on October 20, 2008, to parent Daiichi Sankyo, lapsed since the latter did not convert them into shares.

Warrants are financial instruments which allow the holder to buy shares of a company at a pre-determined price and within a specified period. Warrants are popular with Indian companies as these can be attached to convertible bonds or preferred stock and carry lower interest rates or dividends.
http://www.financialexpress.com/news/one-year-for-fdi-warrant-conversion/612131/

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