India's Investment Environment – September 2008

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I. Introduction

The global financial crisis has added 'new' risks to the world economy threatening to dampen global foreign direct investment (FDI) flows; but India is still expected to remain a hotspot for global investors. The recently released report of United Nations Conference on Trade and Development (UNCTAD) entitled, 'World Investment Report 2008' ranks India as the second best destination for FDI, ahead of US, UK, and Germany and only below China. India has been liberalising its FDI policy by raising investment limits in several key sectors including real estate, petroleum refining, commodity exchanges, mining and civil aviation.

II. Expected Changes in FDI Rules

The FDI policy review is still underway, with the following changes on the anvil:

i Government mulls 26 percent FDI in multi-brand retail

The Government is considering a proposal to allow 26 percent FDI in multi-brand retail. This move will allow global giants to gain a foothold in India. The Government is also considering a single window system for approvals in the retail sector, which currently requires 30 clearances from various departments for a business to be started.

The Government is also considering allowing the scaling up of FDI in single brand retail to 100 percent as well as allowing 51 percent in multi-brand retail of consumer electricals, electronics, sports goods and accessories. However, the proposal to relax investment norms in single-brand retail comes with a series of riders including mandatory sourcing from Indian vendors. Such proposals are expected to be cleared after vetting by the Foreign Investment Promotion Board (FIPB).

In effect, Government proposes to relax the norms with regard to foreign participation in multi-brand retail by opening up specialised sectors, while keeping grocery and consumer goods (retail) out of bound.

ii FDI in DTH may be raised to 74 percent

The Government is exploring the option to raise the current FDI cap from 49 to 74 percent for the Direct-to-Home (DTH) segment. The move is aimed at bringing parity between the DTH and telecom sectors. Telecom companies are allowed FDI up to 74 percent while DTH players only 49 percent.

The Government is also considering rationalising the licence fee of DTH players to align these with the telecom players in the backdrop of convergence of technologies between broadcasting and telecom sectors. At present, DTH operators have to pay 10 percent of their gross revenues as licence fee to the Government. The Government is now considering allowing DTH players to pay a percentage of adjusted gross revenue (AGR) instead. The telecom companies pay revenue share on the AGR.

iii Government open to selective 49 percent FDI in defence

The Government is considering the industry's demand for allowing up to 49 percent FDI in the defence sector on a case-to-case basis. The bidding process is also being made transparent with the implementation of the new Defence Procurement Procedure-2008 (DPP-08).

iv Foreign magazines allowed publication of local editions

The Government has allowed foreign news and current affairs magazines to publish local editions with local news content and advertising conditional on a 26 percent FDI ceiling. Till now, international magazines were allowed to print and distribute their global editions with some local advertising. Foreign companies can now not only apply for permission to reproduce these magazines locally but can also publish local news. The decision is allocable only to foreign news magazines, not newspapers.

This move may be seen as an indication of the Government's future willingness to allow foreign editions of newspapers or perhaps to raise the 26 percent FDI cap in print media to 49 percent.

v Removing procedural complications involved in downstream investments

The Government is considering exempting 'foreign owned Indian companies' from the mandatory FIPB approval for investment in their subsidiaries. This exemption would be granted for sectors where 100 percent FDI is allowed and which come under the automatic route. These include roads, airports, ports, shipping, petroleum and natural gas and manufacturing of telecom equipments. This will be a major relaxation which will reduce the time involved in getting clearance from FIPB. Till date, foreign-owned holding companies need have to obtain FIPB approval as per Press Note 3 of 1997 and Press Note 9 of 1999.

vi Government is considering the removal of FDI sectoral limits for FIIs

The Government is considering a proposal to liberalise norms governing FIIs in India by removing them from the ambit of sectoral limits on foreign investment. In effect, if a particular sector is allowed 49 percent FDI and 25 percent Foreign Institutional Investor (FII) investment, taking the total composite limit to 74 percent, the FII portion will not be counted in the over all sectoral cap.

Some ministries have their reservations in allowing FII investment over and above FDI as this could lead to a demand for hiking the FDI cap in sectors like telecom and stock exchanges.

vii M&A involving foreign companies in the Indian advertisement industry would be easier

The Government is planning to exempt the advertisement industry from Press Note 1, which makes clearance mandatory for a foreign company to start business. The move would make the mandatory NOC from joint venture partners redundant for new investments in the advertising industry. The Government is keen to do this as there are many sub-sectors within the broad categorisation of the advertisement industry, which are independent of each other, and have little clash of interest.

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