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Indian foreign investment policy reforms

Background

The Government of India (GoI) has in the last few months launched a series of initiatives which focussed upon the 'ease of doing business' in India, economic reforms and liberalising foreign investment norms in various sunrise sectors such as defence, rail infrastructure, construction development, insurance, pension, medical devices and white label ATMs.

Continuing with this momentum and objective, the Department of Industrial Policy and Promotion (DIPP) vide Press Note released on 10 November 2015 (Press Note) introduced a number of amendments to the Foreign Direct Investment (FDI) Policy that are essentially aimed at (i) increase in sectoral caps to permit more foreign investments, (ii) bringing more activities under automatic route and (iii) easing some of the conditionalities for foreign investment in certain sectors. The changes introduced by the DIPP have been summarised in the ensuing paragraphs:

I. Sector impact

Construction development sector

Construction development sector in India has been plagued with high cost debt and slump in demand. In order to provide impetus to the sector, the GoI has decided to do away with majority of the onerous conditionalities laid down under Press Note 10 (2014). The Press Note provides that:

- Minimum floor area restriction of 20,000 sq. meters in construction development projects and minimum capitalisation of USD5 million (to be brought in within six months of commencement of business) have been removed.
- Each phase of the construction development project would be considered as a separate project for the purposes of FDI policy.
- Foreign investors will be permitted to exit and repatriate foreign investment before completion of the project under the automatic route, subject to compliance with lock-in conditions of three years (calculated with reference to each tranche of foreign investment). However, the condition of lock-in period will not apply to hotels and tourist resorts, hospitals, special economic zones, educational institutions, old age homes and investment by Non Resident Indians (NRIs).
- Transfer of stake from one non-resident to another, without repatriation of investment will not to be subject to any lock-in period or any government approval.
- Exit is permitted at any time if project or trunk infrastructure is completed before the lock-in period.
- It has been clarified that earning of rent/income on lease of the property, not constituting transfer, will not amount to 'real estate' business.
- 100 per cent FDI under automatic route is permitted in completed projects for operation and management of townships, malls/shopping complexes and business centres. Consequent to foreign investment, transfer of ownership and/or control of the investee company from residents to non-residents is permitted, subject to compliance with minimum lock-in condition of three years, calculated with reference to each tranche of FDI.
- Definition of transfer for the purpose of FDI in the construction development sector has been provided.

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The above-mentioned reforms could help the Indian construction development sector and help achieve GoI's goal of building 50 million houses for the poor and creation and maintenance of leading real-estate infrastructure.

Defence manufacturing

FDI in defence manufacturing sector was increased from 26 to 49 per cent under the government approval route *vide* Press Note 7 (2014). Investments beyond 49 per cent require approval from the Cabinet Committee on Security (CCS). However, since the amendment was made, there has been lukewarm response from global defence manufacturers who have expressed concern over transfer of technology to companies not owned and controlled by them.

In order to allay some of the concerns of defence manufacturers and provide clarity on different routes of investment (FDI and Portfolio investment), the Press Note proposes that:

- Foreign investment up to 49 per cent to be allowed under automatic route.
- Portfolio investment and investment by Foreign Venture Capital Investments (FVCIs) will be allowed upto permitted automatic route level of 49 per cent.
- Proposals for foreign investment in excess of 49 per cent to be considered by Foreign Investment Promotion Board (FIPB)
- In case of infusion of fresh foreign investment within the permitted automatic route level, resulting in change in the ownership pattern or transfer of stake by existing investor to new foreign investor, government approval will be required.

As a stated policy in the Press Note, it is the endeavour of GoI to put more and more FDI proposals on automatic route instead of government route' and allowing FDI upto 49 per cent under the automatic route coupled with recent streamlining of the industrial licence regime is a welcome step.

Single Brand Retail Trading (SBRT)

Although a number of foreign retailers have entered the Indian market under the SBRT, there have been concerns with respect to some of the conditionalities under the FDI policy. The Press Note has liberalised/clarified these conditionalities as under:

- Domestic sourcing requirement (of 30 per cent of value of goods purchased) to be reckoned from the opening of first store, as against present requirement of meeting these from date of infusion of foreign investment.
- To provide an opportunity to high technology single brand entities, in case of 'state-of-art' and 'cutting-edge technology', sourcing norms can be relaxed subject to government approval.
- An entity which has been granted permission to undertake SBRT now permitted to undertake e-commerce activities.
- Indian brands eligible for undertaking SBRT activities.
- Definition of 'Indian manufacturer' has been provided for the purpose of the FDI policy and would include an investee company (owned and controlled by resident Indian citizens/companies), which is the owner of the Indian brand and which manufactures in India, in terms of value, at least 70 per cent of its products in house, and sources, at most 30 per cent from Indian manufacturers.
- 100 per cent FDI permitted in Duty Free Shops under automatic route.
- Same entity permitted to carry out both wholesale and SBRT provided each business separately complies with conditions laid down in the FDI policy.

The above changes, more particularly the significant relaxation in sourcing norms is likely to pave way for global retailers and manufacturers of high-end products for setting up retail operations in India. Permitting e-commerce in SBRT is also a welcome step, and could help these retailers in effectively marketing their products on a pan India basis.

II. Enhancement of FDI limit/approval requirements

In line with the stated objective of bringing a large number of sectors under the automatic approval route, the Press Note has proposed the following enhancement(s) of FDI caps and liberalisation of approval route. These changes are predominantly aimed at media, broadcasting sector and aviation sector.

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Sector/Activity	Erstwhile Cap and Route	New Cap and Route
Broadcasting carriage services		
Teleports	74% (Up to 49% - automatic route Beyond 49% and upto 74% - under government route)	100% (Up to 49% - automatic route Beyond 49% - under government route)
Direct to home		
Cable networks (Multi System operators (MSOs) operating at national or state or district level and undertaking upgradation of networks towards digitalisation and addressability)		
Mobile TV		
Headend-in-the Sky Broadcasting Service (HITS)		
Cable networks (Other MSOs not undertaking upgradation of networks towards digitalisation and addressability and Local Cable Operators (LCOs)	49% - automatic route	
Broadcasting content services		
Terrestrial broadcasting FM (FM Radio)	26% - government route	49% - government route
Up-linking of 'news and current affairs' TV channels		
Up-linking of non news and current affairs' TV channels	100% - government route	100% - automatic route
Down-linking of TV channels		

Sector/Activity	Erstwhile Cap and Route	New Cap and Route
Air transport services		
Non-scheduled air transport service	74% FDI (100% for NRIs) (Automatic up to 49% government route beyond 49% and up to 74%)	100% - automatic route
Ground handling services		
Satellites- establishment and operation		
Satellites-establishment and operation	74% - government route	100% - government route
Credit information companies		
Credit information companies	74% - automatic route (FDI+FII/FPI*) *allowed up to 24% only for listed companies	100% - automatic route (Clarity required if FII/FPI investment condition has changed)

III. Opening up new sectors to FDI

100 per cent foreign investment in plantation activity is presently permitted only in the tea sector with government approval. 100 per cent FDI would now be permitted in the tea sector and also in coffee/rubber/cardamom/palm oil and olive oil plantations under automatic route. In addition to companies engaged in these sectors, this would also benefit manufacturing companies procuring the above products as raw materials for further processing.

Further, regional air transport service is now eligible for foreign investment up to 49 per cent under automatic route.

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IV. Removal of impediments

Full fungibility of foreign investment permitted in banking: Private sector

Although DIPP's Press Note 8 (2015) introduced the concept of composite caps, private banking sector had a specific condition which capped portfolio investment to 49 per cent of the total paid up share capital of said banks. In line with recommendations of the Chandrasekhar Committee, the Press Note has introduced full fungibility of foreign investment in the private banking sector. Accordingly, FIIs/FPIs/QFIs can invest up to sectoral limit of 74 per cent, provided that there is no change of control and management of the investee company. This will provide greater accessibility to foreign capital by the private banking sector.

Investment by companies/trusts/partnerships owned and controlled by NRIs on non-repatriation basis to be treated as domestic investment

Implementing the recommendations of the Mayaram Committee, the Press Note has now reinstated a concept somewhat similar to the erstwhile concept of Overseas Corporate Bodies (OCBs) to include NRI owned and controlled companies, trusts and partnerships. It has been provided that investments made by such entities under Schedule 4 of FEMA (Transfer or Issue of Securities by Person Resident Outside India) Regulations would get covered under Press Note 7 (2015), i.e. treated as domestic investment.

Permitting manufacturers to undertake wholesale and/or retail, including through e-commerce without government approval

In order to promote the 'Make in India' initiative, the Press Note proposes to permit manufacturers to sell their product through a wholesale and/or retail channel, including through e-commerce without government approval. The earlier FDI policy did not, however, place any restrictions on this aspect.

100 per cent FDI in LLPs permitted under automatic route

100 per cent FDI has been permitted under the automatic route in LLPs operating in sectors/activities where 100 per cent FDI is allowed, through the automatic route without FDI-linked conditionalities.

Also, LLPs having foreign investment permitted to make downstream investment in another company or LLP in sectors in which 100 per cent FDI is allowed under the automatic route and there are no FDI-linked performance conditions. These changes will provide flexibility to foreign investors in setting up operations in India under a LLP structure without requirement to seek any prior government approval.

Companies without operations do not to require government approval for FDI for undertaking automatic route sector activities

For infusion of foreign investment into an Indian company which does not have any operations and also does not have any downstream investments, government approval would not be required, for undertaking activities which are under automatic route and without FDI-linked performance conditions.

Establishment and transfer of ownership and control of Indian companies

Approval of the government would be required only if the company concerned is operating in sectors/activities which are under government approval route rather than capped sectors

Swap of shares

No approval of the government shall now be required for investment in automatic route sectors by way of swap of shares. This will foster merger and acquisitions in India and outside India.

Simplification of conditionalities

Certain conditions of the FDI policy on agriculture and animal husbandry, and mining and mineral separation of titanium bearing minerals and ores, its value addition and integrated activities have been simplified. The exact changes are likely to be notified through Press Notes to be issued by DIPP in due course.

Raising the threshold limit for approval by FIPB

Investments beyond INR3,000 crore under government approval route were placed before the Cabinet Committee on Economic Affairs (CCEA) after FIPB clearance. The threshold limit has now been increased to INR5,000 crore. This is expected to speed up the process of obtaining FIPB approval, wherever required.

Conclusion

The above-mentioned amendments have removed key hurdles that were impeding inflow of capital in sectors in need of foreign funds. Allowing foreign investment in several sectors under the automatic route enables swift decision making for foreign investors and brings India closer to the objective of being the preferred investment destination.

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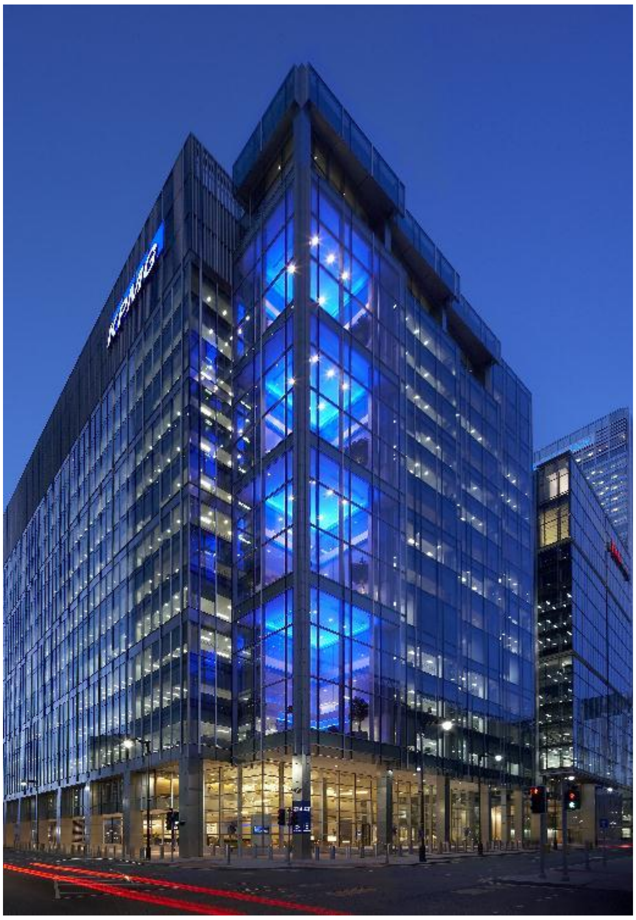
These amendments and/or clarifications should encourage ’fence-sitting’ investors to enter India, especially in sectors such as construction development, e-commerce and defence that complement the GoI’s ’Make in India’ and ’Start-up India’ initiatives. These amendments certainly add to the investor and business friendly ecosystem the GoI is trying to create. However, these would need to be backed up by the labour, land, tax and other reforms that are in the pipeline along with swift implementation and clearances of projects at state level.



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