# Foreign Direct Investment (FDI)

Foreign investment was introduced in 1991 under Foreign Exchange Management Act (FEMA), driven by then finance minister Manmohan Singh. As Singh subsequently became the prime minister, this has been one of his top political problems, even in the current times. India disallowed overseas corporate bodies (OCB) to invest in India. India imposes cap on equity holding by foreign investors in various sectors, current FDI limit in aviation sector is maximum 49%.

Starting from a baseline of less than $1 billion in 1990, a 2012 UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations during 2010–2012. As per the data, the sectors that attracted higher inflows were services, telecommunication, construction activities and computer software and hardware. Mauritius, Singapore, US and UK were among the leading sources of FDI. Based on UNCTAD data FDI flows were $10.4 billion, a drop of 43% from the first half of the last year.

## What is the meaning of FDI?

The Foreign Direct Investment means "cross border investment made by a resident in one economy in an enterprise in another economy, with the objective of establishing a lasting interest in the investee economy.

FDI is also described as "investment into the business of a country by a company in another country". Mostly the investment is into production by either buying a company in the target country or by expanding operations of an existing business in that country". Such investments can take place for many reasons, including to take advantage of cheaper wages, special investment privileges (e.g. tax exemptions) offered by the country.

### Why Countries Seek FDI?

- Domestic capital is inadequate for purpose of economic growth;
- Foreign capital is usually essential, at least as a temporary measure, during the period when the capital market is in the process of development;
- Foreign capital usually brings it with other scarce productive factors like technical knowhow, business expertise and knowledge

## Advantages of FDI:

- Improves forex position of the country;
- Employment generation and increase in production ;
- Help in capital formation by bringing fresh capital;
- Helps in transfer of new technologies, management skills, intellectual property
- Increases competition within the local market and this brings higher efficiencies
- Helps in increasing exports;
- Increases tax revenues

## Disadvantages of FDI:

- Domestic companies fear that they may lose their ownership to overseas company
- Small enterprises fear that they may not be able to compete with world class large companies and may ultimately be edged out of business;
- Large giants of the world try to monopolise and take over the highly profitable sectors;
- Such foreign companies invest more in machinery and intellectual property than in wages of the local people;
- Government has less control over the functioning of such companies as they usually work as wholly owned subsidiary of an overseas company;

## Brief Latest Developments on FDI (all sectors including retail):-

| YEAR<br>SECTORS (%) | GOVERNMENT<br>REMARKS |
|---|---|
| 2012 – October<br>➢ In the insurance sector from 26% to 49%;<br>➢ In the pension sector it approved a 26 percent FDI; | The government cleared amendments to raise the FDI cap.<br>**Note**: Indian Parliament will have to give its approval for the final shape |
| 2012 - September<br>➢ Allowed 51% foreign investment in multi-brand retail,<br>➢ Relaxed FDI norms for civil aviation and broadcasting sectors. – FDI cap in Broadcasting was raised to 74% from 49%;<br>➢ Allowed foreign investment in power exchanges | The government approved. |
| 2012 – December<br>➢ The Indian government removed the 51 percent cap on FDI into single-brand retail outlets and thus opened the market fully to foreign investors by permitting 100 percent foreign investment in this area. | |

## Explain the forms in which business can be conducted by a foreign company in India

A foreign company planning to set up business operations in India may:

- Incorporate a company under the Companies Act, 1956, as a Joint Venture or a Wholly Owned Subsidiary.
- Set up a Liaison Office / Representative Office or a Project Office or a Branch Office of the foreign company

## What is the procedure for receiving Foreign Direct Investment in an Indian company?

An Indian company may receive Foreign Direct Investment under the two routes as given under:

- **Automatic Route**

FDI is allowed under the automatic route without prior approval either of the Government or the Reserve Bank of India in all activities/sectors as specified in the consolidated FDI Policy, issued by the Government of India from time to time.

- **Government Route**

FDI in activities not covered under the automatic route requires prior approval of the Government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, and Ministry of Finance.

## What is Scope of FDI in India? Why World is looking towards India for Foreign Direct Investments:

India is the 3rd largest economy of the world in terms of purchasing power parity and thus looks attractive to the world for FDI. Even Government of India, has been trying hard to do away with the FDI caps for majority of the sectors, but there are still critical areas like retailing and insurance where there is lot of opposition from local Indians / Indian companies.

Some of the major economic sectors where India can attract investment are as follows:-

1. Telecommunications
2. Apparels
3. Information Technology
4. Pharmacy
5. Auto parts
6. Jewellery
7. Chemicals

In last few years, certainly foreign investments have shown upward trends but the strict FDI policies have put hurdles in the growth in this sector. India is however set to become one of the major recipients of FDI in the Asia-Pacific region because of the economic reforms for increasing foreign investment and the deregulation of this important sector. India has technical expertise and skilled managers and a growing middle class market of more than 300 million and this represents an attractive market.

## Background and Recent Developments for FDI in Retail Sector which has raised lot of controversies in political circles:

As part of the economic liberalization process set in place by the Industrial Policy of 1991, the Indian government has opened the retail sector to FDI slowly through a series of steps:

| YEARS | REMARKS |
|---|---|
| 1995 | World Trade Organisation's (WTO) General Agreement on Trade in Services, which includes both wholesale and retailing services, came into effect |
| 1997 | FDI in cash and carry (wholesale) with 100% rights allowed under the government approval route; |
| 2006 | FDI in cash and carry (wholesale) was brought under automatic approval route; Up to 51% investment in single brand retail outlet permitted, subject to Press Note 3 (2006 series) |
| 2011 | 100% FDI in Single Brand Retail allowed' |
| 2012 | On Sept. 13, Government approved the allowance of 51 percent foreign investment in multi-brand retail, [ It also relaxed FDI norms for civil aviation and broadcasting sectors] |

## Name the sectors where FDI is NOT allowed in India, both under the Automatic Route as well as under the Government Route?

FDI is prohibited under the Government Route as well as the Automatic Route in the following sectors:

1. Atomic Energy
2. Lottery Business
3. Gambling and Betting
4. Business of Chit Fund
5. Nidhi Company
6. Agricultural (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro and allied sectors) and Plantations activities (other than Tea Plantations)
7. Housing and Real Estate business (except development of townships, construction of residential/commercial premises, roads or bridges to the extent specified in notification
8. Trading in Transferable Development Rights (TDRs).
9. Manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

**Sectors/Activities falling under Government Route with percentage of FDI permitted**

### Upto 26 %

- Defence Industry subject to Industrial license under the IDRA
- Terrestrial Broadcasting FM (FM Radio)
- Up-linking a News & Current Affairs TV Channel
- Publishing of Newspaper and periodicals dealing with news and current affairs
- Publication of Indian editions of foreign magazines dealing with news and current affairs
- Banking- Public Sector (up to 20% only)

### Upto 49 %

- Petroleum refining by PSU without any disinvestment or dilution of domestic equity in the existing PSUs.
- Cable Network & DTH ( FDI component not to exceed 20%)
- Setting up of Up-linking HUB/ Teleports
- Private Security Agencies
- Commodity exchange
- Credit Information Companies
- Infrastructure Company in the Securities Market
- Financial Services ARC (49% of paid up capital of ARC)

### Upto 74 %
(Automatic upto 49%)

- Headend-In-The-Sky (HITS) Broadcasting Service
- Non-Scheduled Air Transport Service
- Ground Handling Services
- Satellites – Establishment and operation, subject to the sectoral guidelines of Department of Space/ISRO
- Telecom services
- Internet Service Providers with/without gateways, radip paging, end to end bandwith
- Banking –Private sector

### Upto 100 %

- Mining and mineral separation of titanium bearing minerals and ores,
- Up-linking a Non-News & Current Affairs TV Channel
- Publishing/printing of Scientific and Technical Magazines/specialty journals/ periodicals
- Publication of fax edition of foreign newspapers
- Airports - Exisiting Project
- Courier services
- Tea Plantation
- Financial Services
- Test Marketing
- Infrastructure provider (dark fibre, right of way, duct space, tower, electronic, voice mail)

## Name the authorities dealing with Foreign Investment:

- Foreign Investment Promotion Board (popularly known as FIPB): The Board is responsible for expeditious clearance of FDI proposals and review of the implementation of cleared proposals. It also undertake investment promotion activities and issue and review general and sectorial policy guidelines;
- Secretariat for Industrial Assistance (SIA): It acts as a gateway to industrial investment in India and assists the entrepreneurs and investors in setting up projects. SIA also liaison with other government bodies to ensure necessary clearances;
- Foreign Investment Implementation Authority (FIIA) : The authority works for quick implementation of FDI approvals and resolution of operational difficulties faced by foreign investors;
- Investment Commission
- Project Approval Board
- Reserve Bank of India

## What are the instruments for receiving Foreign Direct Investment in an Indian company?

Foreign investment is reckoned as FDI only if the investment is made in equity shares, fully and mandatorily convertible preference shares and fully and mandatorily convertible debentures with the pricing being decided upfront as a figure or based on the formula that is decided upfront. Any foreign investment into an instrument issued by an Indian company which: gives an option to the investor to convert or not to convert it into equity or does not involve upfront pricing of the instruments a date would be reckoned as ECB and would have to comply with the ECB guidelines.

The FDI policy provides that the price/ conversion formula of convertible capital instruments should be determined upfront at the time of issue of the instruments. The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with the extant FEMA regulations [the DCF method of valuation for the unlisted companies and valuation in terms of SEBI (ICDR) Regulations, for the listed companies].

## MODES OF INVESTMENT UNDER FDI

Foreign Direct Investment in India can be done through following modes:

**Modes of FDI**

| Fresh Issuance to a person reident outside India of: | Acquisition by way of transfer by a person resident outside India: |
|---|---|
| 1. Shares | 1. NR to NR (Sale/Gift) |
| 2. Convertible Debentures | 2. NRI to NRI (Sale/Gift) |
| | 3. NR to R (Sale/Gift) |
| | 4. R to NR (Sale) |
| | 5. NR on Stock Exchange |

## Prior permission of RBI is required in following cases:

1. Indian company engaged in financial services sector, Insurance, Infrastructure companies in the securities market.
2. Transactions which attract the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997
3. Activity of Indian Company falls outside automatic route and FIPB approval is obtained for transfer.
4. Pricing guidelines are not adhered
5. Payment of consideration by non-resident is proposed to be deferred.
6. Transfer by way of gift from resident to non-resident.
7. Transfer of shares from NRI to NR.

## Pricing Guidelines on Transfers:

- **In Case Of Transfer Of Shares From Resident To Non-Resident**

  1. In case of listed shares, at a price which is not less than the price at which a preferential allotment of shares would be made under SEBI guidelines.
  2. In case of unlisted shares at a price which is not less than the fair value as per the Discount Free Cash Flow (DCF) Method to be determined by a SEBI registered Category-I- Merchant Banker/Chartered Accountant.

- **In Case Of Transfer Of Shares From Non-Resident To Resident**

  The price should not be more than the minimum price at which the transfer of shares would have been made from a resident to a non-resident.

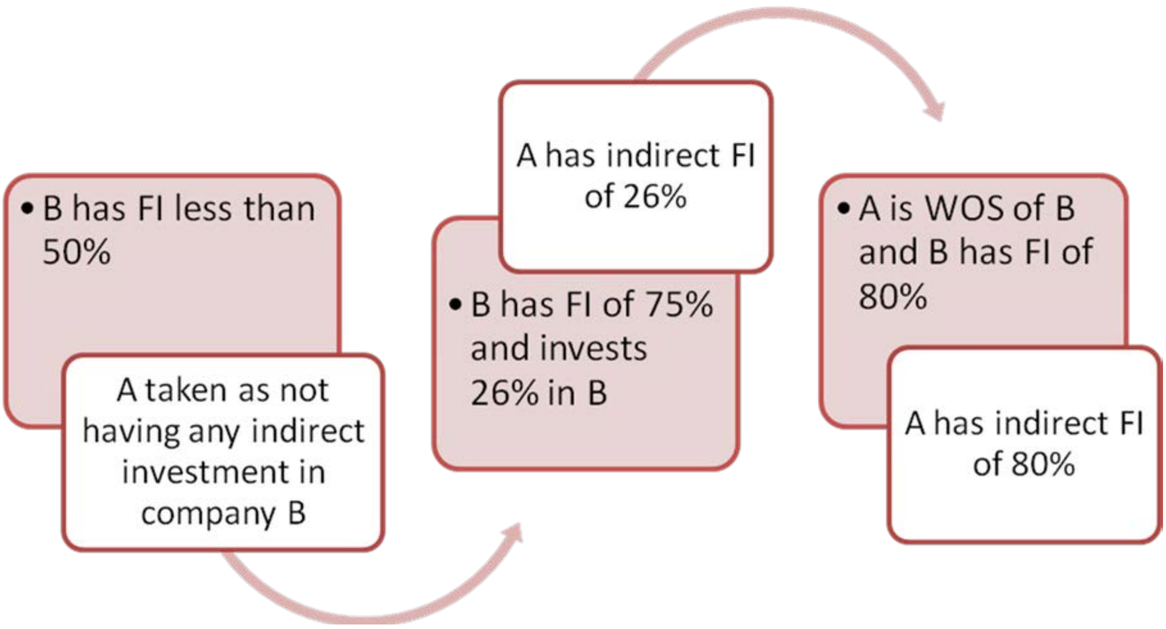
## CALCULATION OF TOTAL FOREIGN INVESTMENT

1. **Direct Foreign Investment:** All investment directly by a non-resident entity into the Indian company would be counted towards foreign investment.

2. **Indirect Foreign Investment**: The foreign investment through the investing Indian company would not be considered for calculation of the indirect foreign investment in case of Indian companies which are owned **and** controlled by resident Indian citizens and/or Indian Companies which are owned and controlled by resident Indian citizens. For cases where condition (a) above is not satisfied or if the investing company is owned **or** controlled by 'non- resident entities', the entire investment by the investing company into the subject Indian Company would be considered as indirect foreign investment, provided that, as an exception, the indirect foreign investment in only the 100% owned subsidiaries of operating-cum- investing/investing companies, will be limited to the foreign investment in the operating-cum-investing/ investing company.

## Illustration:

If the indirect foreign investment is being calculated for Company A which has investment through an investing Company B having foreign investment, the following would be the method of calculation:



# Types of FDI in different sectors:

## FDI IN PARTNERSHIP FIRM/PROPRIETARY CONCERN

1. **ON NON-REPATRIATION BASIS** –Amount is invested by inward remittance or out of NRE / FCNR (B) / NRO account the firm or proprietary concern is not engaged in any agricultural / plantation or real estate business or print media sector.
2. **WITH REPATRIATION BENEFITS** –NRIs / PIO may seek prior permission of Reserve Bank for investment in sole proprietorship concerns / partnership firms with repatriation benefits. An NRI or PIO is not allowed to invest in a firm or proprietorship concern engaged in any agricultural/plantation activity or real estate business or engaged in Print Media.

## FDI IN MICRO AND SMALL ENTERPRISES (MSEs)

### MANUFACTURE OF ITEMS RESERVED FOR PRODUCTION IN MICRO AND SMALL ENTERPRISES (MSES)

1. FDI in MSEs will be subject to the sectorial caps, entry routes and other relevant sectorial regulations.
2. Any industrial undertaking which is not a MSE, but manufactures items reserved for the MSE sector would require Government approval where foreign investment is more than 24% in the capital.
3. Such an undertaking would also require an Industrial License under the IDRA.
4. The issue of Industrial License is subject to a few general conditions and the specific condition that the Industrial Undertaking shall undertake to export a minimum of 50% of the new or additional annual production of the MSE reserved items to be achieved within a maximum period of 3 years.
5. The export obligation would be applicable from the date of commencement of commercial production and in accordance with the provisions of section 11 of the IDRA.

## FDI IN LIMITED LIABILITY PARTNERSHIPS (LLPs)

1. LLPs with FDI will be allowed, through the Government approval route, in those sectors/activities where 100% FDI is allowed, through the automatic route and there are no FDI-linked performance related conditions.
2. By FDI-linked performance related conditions, it is meant that in sectors, where conditions like minimum capitalization etc are prescribed like development of Townships, NBFC, even though 100% FDI is allowed under automatic route, LLP's will not be allowed to bring FDI with the approval of Government of India.
3. LLPs with FDI will not be allowed to operate in agricultural/plantation activity, print media or real estate business.
4. LLPs with FDI will not be eligible to make any downstream investments, which mean LLP having FDI, cannot make further investment in LLP or companies engaged in any business, even though 100% FDI is allowed under those sectors.
5. An Indian Company, having FDI, will be permitted to make downstream investment in LLPs only if both the company, as well as the LLP is operating in sectors where 100% FDI is allowed, through the automatic route and there are no FDI-linked performance related conditions.
6. Foreign Capital participation in the capital structure of the LLPs will be allowed only by way of cash considerations, received by inward remittance, through normal banking channels, or by debit to NRE/FCNR account of the person concerned, maintained with an authorized dealer/authorized bank. For making non cash/intangible contribution towards the capital of the LLP, permission of **Government** of India will be required.
7. Foreign Institutional Investors (Flls) and Foreign Venture Capital Investors (FVCIs) will not be permitted to invest in LLPs.
8. LLPs will also not be permitted to avail External Commercial Borrowings (ECBs)
9. The designated partners will be responsible for compliance with the above conditions and liable for all penalties imposed on the LLP for their contravention.
10. In case of LLP having FDI and a body corporate is a designated partner, than the body corporate should only be a company registered under the Companies Act and not any other body, such as an LLP or a trust.
11. Any conversion of a company with FDI into an LLP will be allowed only if the company is engaged in sectors/activities where 100% FDI is allowed, through the automatic route and there are no FDI-linked performance related conditions and prior approval of FIPB/Government is obtained.

## CONVERSION OF ECB INTO EQUITY

**Conversion of ECB into equity is permitted subject to the following conditions:**

- The activity of the company is covered under the Automatic Route for Foreign Direct Investment or Government (FIPB) approval for foreign equity participation has been obtained by the company, wherever applicable.
- The foreign equity holding after such conversion of debt into equity is within the sectoral cap, if any,
- Pricing of shares is as per the pricing guidelines issued under FEMA, 1999 in the case of listed/ unlisted companies.

**Full Conversion**

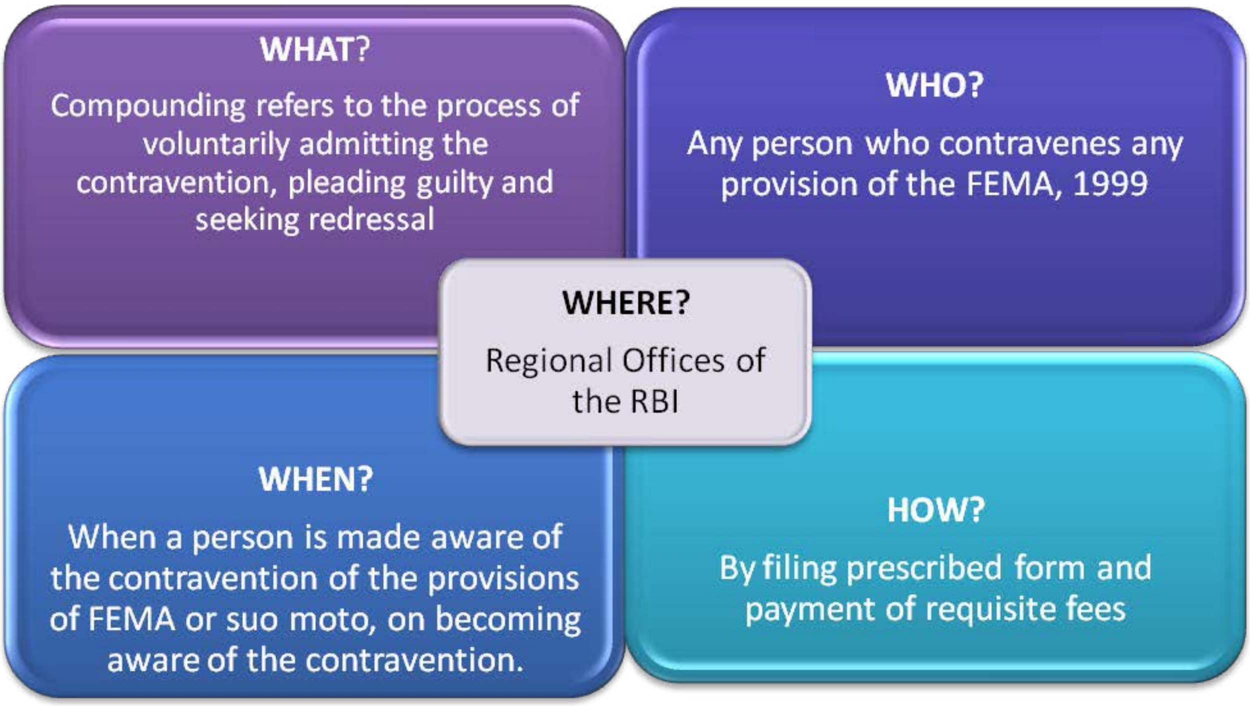
- To file form FC-GPR to the Regional Office of RBI as well as in form ECB-2 submitted to the DSIM, RBI within 7 working days from the close of month to which it relates. The words "ECB wholly converted to equity" should be clearly indicated on top of the ECB-2 form. Once reported, filing of ECB-2 in the subsequent months is not necessary.

**Partial Conversion**

- Borrowers are required to report the converted portion in form FCGPR to the Regional Office as well as in form ECB-2 clearly differentiating the converted portion from the unconverted portion. The words "ECB partially converted to equity" should be indicated on top of the ECB-2 form. In subsequent months, the outstanding portion of ECB should be reported in ECB-2 form.

## COMPOUNDING UNDER FEMA

Contravention is a breach of the provisions of the Foreign Exchange Management Act (FEMA), 1999 and rules/ regulations/ notification/ orders/ directions/ circulars issued there under. The Reserve Bank is empowered to compound any contraventions as defined under section 13 of FEMA, 1999 except the contravention under section 3(a), for a specified sum after offering an opportunity of personal hearing to the contravener. It is a voluntary process in which an Indian citizen or a corporate seeks compounding of an admitted contravention. It provides comfort to any person who contravenes provisions of FEMA, 1999.



## What are the Total Inflows of FDI in India :

- For the FY 2012-13 (for the month of July, 2012) was US$ 1.47 billion.
- Amount of FDI equity inflows for the financial year 2012-13 (from April 2012 to July 2012) stood at US$ 5.90 billion.
- Cumulative amount of FDI (from April 2000 to July 2012) into India stood at US$ 176.76 billion.

### FDI Equity Inflows from 2000-2012

| S. No | Financial Year (April – March) | Amount of FDI Inflows | | %age growth over previous year (in terms of US $) |
|---|---|---|---|---|
| | | In Rs, crores | In US$ million | |
| 1 | 2000-01 | 10733 | 2463 | - |
| 2 | 2001-02 | 18654 | 4065 | ( + ) 65 % |
| 3 | 2002-03 | 12871 | 2705 | ( - ) 33 % |
| 4 | 2003-04 | 10064 | 2188 | ( - ) 19 % |
| 5 | 2004-05 | 14653 | 3219 | ( + ) 47 % |
| 6 | 2005-06 | 24584 | 5540 | ( + ) 72 % |
| 7 | 2006-07 | 56390 | 12492 | (+ )125 % |
| 8 | 2007-08 | 98642 | 24575 | ( + ) 97 % |
| 9 | 2008-09 '*' | 142829 | 31396 | ( + ) 28 % |
| 10 | 2009-10 # | 123120 | 25834 | ( - ) 18 % |
| 11 | 2010-11 # | 88520 | 19427 | ( - ) 25 % |
| 12 | 2011-12 # (April - January 2012) | 122307 | 26192 | - |
| **CUMULATIVE TOTAL (from April 2000 to January 2012)** | | 723367 | 160096 | - |

(a) Including amount remitted through RBI‟s-NRI Schemes (2000-2002).
(b) FEDAI (Foreign Exchange Dealers Association of India) conversion rate from rupees to US dollar applied, on the basis of monthly average rate provided by RBI (DEAP), Mumbai.
(c) Variation in equity inflows reported in above Table II-A & II-B for 2006-07, 2007-08, 2008-09, 2009-10 & 2010-11 is due to difference in reporting of inflows by RBI in their monthly report to DIPP & monthly RBI bulletin.
(d) ) # Figures for the years 2009-10, 2010-11 & 2011-12 are provisional subject to reconciliation with RBI.
(e) „*‟ An additional amount of US$ 4,035 million pertaining to the year 2008-09, since reported by RBI, has been included in FDI data base from February 2012.

## Which country tops in inflow of FDI Since 2000-2010? Top 5 Countries for FDI:

| Country | Iinflow in % age terms | Inflows in absolute Terms (million US dollars) |
|---|---|---|
| **Mauritius** | 42% | 50164 |
| **Singapore** | 9 | 11275 |
| **USA** | 7 | 8914 |
| **UK** | 5 | 6158 |
| **Netherlands** | 4 | 4968 |

Majority of the foreign direct investment comes through Mauritius as it enjoys several tax advantages, which works well for the international investors.

## LATEST NEWS REGARDING FDI IN INDIA

| DATE | REMARKS |
|---|---|
| 9 OCT-13 | Wal-Mart and Bharti Enterprises announce end of their India joint venture |
| 7 OCT-13 | Vodafone seeks nod to up stake for about $2.7bn in Indian arm |
| 30 SEP-13 | Current account deficit widens to 4.9% in June quarter |
| 18 SEP-13 | FDI inflow rises 12% to $1.7bn in July |
| 12 SEP-13 | Sebi finalises easier rules for foreign investors |
| 8 SEP-13 | FDI up 6% to $10.87 billion in January -June 2013 |
| 1 SEP-13 | India receives highest FDI worth $1 bn in pharmacy in Apr-Jun |
| 14 AUG-13 | Panel for FDi ban in Pharmacy companies |
| 28 JUNE-13 | GoAir expects FDI in 2013-2014 |