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Foreign Direct Investment whenever Risk under Globalisation

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Foreign direct investment (FDI) is a key element in international economic integration. FDI creates direct, stable and long-lasting links between economies. It encourages the transfer of technology and know-how between countries, and allows the host economy to promote its products more widely in international markets. FDI is also an additional source of funding for investment and, under the right policy environment; it can be an important vehicle for development.

Definition

FDI is defined as cross-border investment by a resident entity in one economy with the objective of obtaining a lasting interest in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the enterprise. Ownership of at least 10% of the voting power, representing the influence by the investor, is the basic criterion used.

Inward stocks at a given point in time refer to all direct investments by non-residents in the reporting economy; outward stocks are the investments of the reporting economy abroad. Corresponding flows relate to investment during a period of time. Negative flows generally indicate disinvestments or the impact of substantial reimbursements of inter-company loans.

The FDI index gauges the restrictiveness of a country's FDI rules through four types of restrictions: foreign equity limitations; screening or approval mechanisms; restriction on key foreign employment; operational restrictions.

The OECD FDI regulatory restrictiveness indexes presented here demonstrate that the services sector tend to have higher FDI restrictions across countries, followed by primary sectors. The manufacturing sector remains the most open economic sector.

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Comparability

In recent years the comparability of FDI statistics has improved significantly but asymmetries remain between inward and outward FDI.

<u>Types of FDI</u>

There are two types of FDI:

- Greenfield investment: It is the direct investment in new facilities or the expansion of existing facilities. It is the principal mode of investing in developing countries like India.
- Mergers and Acquisition: It occurs when a transfer of existing assets from local firms takes place.

Forbidden Territories:

FDI is not permitted in the following industrial sectors:

- Arms and ammunition
- Atomic Energy.
- Railway Transport.
- Coal and lignite.
- Mining of iron, manganese, chrome, gypsum, sulphur, gold, diamonds, copper, zinc.

Investment in India

Government of India accepts the key role of Foreign Direct Investment (FDI) in economic development not only as an addition to domestic capital but also as an important source of technology and global best practices. The Government of India has put in place a liberal and Transparent FDI policy.

FDI up to 100% is allowed under the automatic route in most sectors/activities. FDI policy in India is reckoned to be among the most liberal in emerging economies. FDI Policy permits FDI up to 100 % from foreign/NRI investor without prior approval in most of the sectors including the services sector under automatic route. FDI in sectors/activities under automatic route does not require any prior approval either by the Government or the RBI.

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Foreign Direct Investment Policy

Foreign direct investment (FDI) has become an integral part of national development strategies for almost all the nations globally. Its global popularity and positive output in augmenting of domestic capital, productivity and employment; has made it an indispensable tool for initiating economic growth for countries.

India is evolving as one of the 'most favored destination' for FDI in Asia and the Pacific. It has displaced US as the second-most favored destination for FDI in the world after China according to an AT Kearney's FDI Confidence Index. India attracted more than three times foreign investment at US$ 7.96 billion during the first half of 2005-06 fiscal, as against US$ 2.38 billion during the subsequent period of 2004-05.

FDI in India has contributed effectively to the overall growth of the economy in the recent times. FDI inflow has an impact on India's transfer of new technology and innovative ideas; improving infrastructure, thus makes a competitive business environment.

FDI policy is reviewed on an ongoing basis and measures for its further liberalization are taken. Change in sectoral policy/sectoral equity cap is notified from time to time through Press Notes by the Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy announcement by SIA are subsequently notified by RBI under FEMA. All Press Notes are available at the website of Department of Industrial Policy & Promotion.

FDI Policy permits FDI up to 100 % from foreign/NRI investor without prior approval in most of the sectors including the services sector under automatic route. FDI in sectors/activities under automatic route does not require any prior approval either by the Government or the RBI. The investors are required to notify the Regional office concerned of RBI of receipt of inward remittances within 30 days of such receipt and will have to file the required documents with that office within 30 days after issue of shares to foreign investors.

Automatic Route

All activities which are not covered under the automatic route prior Government approval for FDI/NRI shall be necessary. Areas/sectors/activities hitherto not open to FDI/NRI investment shall continue to be so unless otherwise decided and notified by Government. An investor can make an application for prior Government approval even when the proposed activity is under the automatic route.

Procedure for obtaining Government approval- FIPB

The Foreign Investment Promotion Board (FIPB) considers approving all proposals for foreign investment, which requires Government approval. The FIPB also grants composite approvals involving foreign investment/foreign technical collaboration.

For seeking the approval for FDI other than NRI Investments and 100% EOU, applications in form FC-IL should be submitted to the Department of Economic Affairs (DEA), Ministry of Finance.

FDI from NRI & for 100% EOU

FDI applications with NRI Investments and 100% EOU should be submitted to the Public Relation & Complaint (PR&C) Section of Secretariat of Industrial Assistance (SIA), Department of Industrial Policy & Promotion.

Proposals requiring Govt's approval

Application for proposals requiring prior Government's approval should be submitted to FIPB in FC-IL form. Plain paper applications carrying all relevant details are also accepted. No fee is payable. The following information should form part of the proposals submitted to FIPB: - Whether the applicant has had or has any previous/existing financial/ technical collaboration or trade mark agreement in India in the same or allied field for which approval has been sought; and If so, details thereof and the justification for proposing the new venture/ technical collaboration (including trademarks).

Applications can also be submitted with Indian Missions abroad who will forward them to the Department of Economic Affairs for further processing. Foreign investment proposals received in the DEA are placed before the Foreign Investment Promotion Board (FIPB) within 15 days of receipt. The decision of the Government in all cases is usually conveyed by the DEA within 30 days.

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FDI Prohibited

FDI is not permissible in Gambling and Betting, or Lottery Business, Business of chit fund, Nidhi Company, Housing and Real Estate business, Trading in Transferable Development Rights (TDRs), Retail Trading, Atomic Energy Agricultural or plantation activities or Agriculture (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(other than Tea plantations)

General permission of RBI under FEMA

RBI has granted general permission under Foreign Exchange Management Act (FEMA) in respect of proposals approved by the Government. Indian companies getting foreign investment approval through FIPB route do not require any further clearance from RBI for the purpose of receiving inward remittance and issue of shares to the foreign investors.

The companies are, however, required to notify the Regional office concerned of the RBI of receipt of inward remittances within 30 days of such receipt and to file the required documents with the concerned Regional offices of the RBI within 30 days after issue of shares to the foreign investors or NRIs.

Besides new companies, automatic route for FDI/NRI investment is also available to the existing companies proposing to induct foreign equity. For existing companies with an expansion programme, the additional requirements include:

The increase in equity level resulting from the expansion of the equity base of the existing company without the acquisition of existing shares by NRI/foreign investors, the money to be remitted should be in foreign currency and proposed expansion programme should be in the sector(s) under automatic route. Otherwise, the proposal would need Government approval through the FIPB. For this a Board Resolution of the existing Indian company must support the proposal.

For existing companies without an expansion programme, the additional requirements for eligibility for automatic approval are: that they are engaged in the industries under automatic route; the increase in equity level must be from expansion of the equity base and the foreign equity must be in foreign currency.

The earlier SEBI requirement, applicable to public limited companies, that shares allotted on preferential basis shall not be transferable in any manner for a period of 5 years from the date of their allotment has now been modified to the extent that not more than 20 per cent of the entire contribution brought in by promoter cumulatively in public or preferential issue shall be locked-in. Equity participation by international financial institutions such as ADB, IFC, CDC, DEG, etc. in domestic companies is permitted through automatic route subject to SEBI/RBI regulations and sector specific cap on FDI

ADR/GDR

An Indian corporate can raise foreign currency resources abroad through the issue of American Depository Receipts (ADRs) or Global Depository Receipts (GDRs). Regulation 4 of Schedule I of FEMA Notification no. 20 allows an Indian company to issue its Rupee denominated shares to a person resident outside India being a depository for the purpose of issuing Global Depository Receipts (GDRs) and/ or American Depository Receipts (ADRs), subject to the conditions that:

the ADRs/GDRs are issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Central Government there under from time to time The Indian company issuing such shares has an approval from the Ministry of Finance, Government of India to issue such ADRs and/or GDRs or is eligible to issue ADRs/ GDRs in terms of the relevant scheme in force or notification issued by the Ministry of Finance, and

There are no end-use restrictions on GDR/ADR issue proceeds, except for an express ban on investment in real estate and stock markets. The FCCB issue proceeds need to conform to external commercial borrowing end user requirements; in addition, 25 per cent of the FCCB proceeds can be used for general corporate restructuring.

Is not otherwise ineligible to issue shares to person's resident outside India in terms of these Regulations. There is no limit up to which an Indian company can raise ADRs/GDRs. However, the Indian company has to be otherwise eligible to raise foreign equity under the extant FDI policy.

A company engaged in the manufacture of items covered under Automatic route, whose direct foreign investment after a proposed GDRs/ADRs/FCCBs issue is likely to exceed the percentage limits under the automatic route, or which is implementing a project falling under

Government approval route, would need to obtain prior Government clearance through FIPB before seeking final approval from the Ministry of Finance.

Foreign currency convertible Bonds

FCCBs are issued in accordance with the scheme [the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993] and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments;

The eligibility for issue of Convertible Bonds or Ordinary Shares of Issuing Company is given as under:

An issuing company desirous of raising foreign funds by issuing Foreign Currency Convertible Bonds or ordinary shares for equity issues through Global Depositary Receipt Can issue FCCBs, upto USD 50 Million under the Automatic route, From USD 50 -100 Million, the companies have to take RBI approval, From USD 100 Million and above, prior permission of the Department of Economic Affairs is required.

Preference Shares

Foreign investment through preference shares is treated as foreign direct investment. Proposals are processed either through the automatic route or FIPB as the case may be, as per the following guidelines:

Foreign investment in preference share is considered as part of share capital and fall outside the External Commercial Borrowing (ECB) guidelines/cap. Preference shares to be treated as foreign direct equity for purpose of sectoral caps on foreign equity, where such caps are prescribed, provided they carry a conversion option. Preference shares structured without such conversion option fall outside the foreign direct equity cap.

Duration for conversion shall be as per the maximum limit prescribed under the Companies Act or what has been agreed to in the shareholders agreement whichever is less. The dividend rate would not exceed the limit prescribed by the Ministry of Finance. Issue of preference shares should conform to guidelines prescribed by the SEBI and RBI and other statutory requirements.

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FDI in EOUs/SEZs/Industrial Park/EHTP/STP

Special Economic Zones

100% FDI is permitted under automatic route for setting up of Special Economic Zone. Units in SEZ qualify for approval through automatic route subject to sectoral norms. Details about the type of activities permitted are available in the Foreign Trade Policy issued by Department of Commerce. Proposals not covered under the automatic route require approval by FIPB.

Export Oriented Units (EOUs)

100% FDI is permitted under automatic route for setting up 100% EOU, subject to sectoral norms. Proposals not covered under the automatic route would be considered and approved by FIPB.

Industrial Park

100% FDI is permitted under automatic route for setting up of Industrial Park.

Electronic Hardware Technology Park (EHTP) Units All proposals for FDI/NRI investment in EHTP Units are eligible for approval under automatic route. For proposals not covered under automatic route, the applicant should seek separate approval of the FIPB.

Software Technology Park Units

All proposals for FDI/NRI investment in STP Units are eligible for approval under automatic route. For proposals not covered under automatic route, the applicant should seek separate approval of the FIPB.

Capitalization of Import Payables

FDI inflows are required to be under the following modes:

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By inward remittances through normal banking channels or by debit to the specified account of person concerned maintained in an authorized dealer/authorized bank. Issue of equity to non-residents against other modes of FDI inflows or in kind is not permissible.

However, Issue of equity shares against lump sum fee, royalty payable and external commercial borrowings (ECBs) in convertible foreign currency are permitted, subject to meeting all applicable tax liabilities and sector specific guidelines.

Exchange Control Management

FEMA

The Reserve Bank of India's Exchange Control Department, administers Foreign Exchange Management Act, 1999, (FEMA) which has replaced the earlier act, FERA, with effect from June 1, 2000. The new legislation is for "facilitating external trade" and "promoting the orderly development and maintenance of foreign exchange market in India". FEMA extends to the whole of India. Under FEMA an Indian company with foreign equity participation is treated at par with other locally incorporated companies. Accordingly, the exchange control laws and regulations for residents apply to foreign-invested companies as well.

FDI in Indian Company

In terms of Section 6(3) (b) of Foreign Exchange Management Act. 1999 Reserve Bank regulates transfer or issue of any security by a person resident outside India read with Notification No. FEMA 20/2000-RB dated May 3, 2000

Issue of Rights/ Bonus Shares

General permission is available to Indian companies to issue Right/Bonus shares subject to certain conditions. Entitlement of rights shares is not automatically available to investors who have been allotted such shares as OCBs. Such issuing companies would have to seek specific permission from RBI, Foreign Exchange Department, Foreign Investment Division, Central Office, Mumbai for issue of shares on right basis to erstwhile OCBs. However, bonus shares can be issued to OCBs.

Issue of shares under ESOS scheme

A company may issue shares under this Scheme, to its employees or employees of its joint venture or wholly owned subsidiary abroad who are resident outside India, directly or through a Trust subject to the condition that the scheme has been drawn in terms of relevant regulations issued by the SEBI; and face value of the shares to be allotted under the scheme to the non-resident employees does not exceed 5% of the paid-up capital of the issuing company.

Issue of shares under merger/amalgamation

An Indian corporate can raise foreign currency resources abroad through the issue of ADRs or GDRs. Regulation 4 of Schedule I of FEMA Notification no. 20 allows an Indian company to issue its Rupee denominated shares to a person resident outside India being a depository for the purpose of issuing GDRs and/ or ADRs, subject to the conditions that: the ADRs/GDRs are issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Central Government there under from time to time.

The Indian company issuing such shares has an approval from the Ministry of Finance, Government of India to issue such ADRs and/or GDRs or is eligible to issue ADRs/ GDRs in terms of the relevant scheme in force or notification issued by the Ministry of Finance, and Is not otherwise ineligible to issue shares to persons resident outside India in terms of these Regulations.

Repatriation of investment Capital and profits Earned in India

All foreign investments are freely reparable except for the cases where NRIs choose to invest specifically under non-reparable schemes. Dividends declared on foreign investments can be remitted freely through an Authorised Dealer.

Non-residents can sell shares on stock exchange without prior approval of RBI and repatriate through a bank the sale proceeds if they hold the shares on repatriation basis and if they have necessary NOC/tax clearance certificate issued by Income Tax authorities. For sale of shares through private arrangements, Regional offices of RBI grant permission for recognized units of foreign equity in Indian company in terms of guidelines indicated in Regulation 10.B of Notification No. FEMA.20/2000 RB dated 3rd May 2000. The sale price of shares on recognised units is to be determined in accordance with the guidelines prescribed under Regulation 10B (2) of the above Notification.

Profits, dividends, etc. (which are remittances classified as current account transactions) can be freely repatriated.

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