CHAPTER 2

FDI INFLOW AS A SUPPLEMENT

TO DOMESTIC CAPITAL BASE
2.0 INTRODUCTION:

Foreign capital flow at any given point of time supplements short fall or vacuum prevailing in domestic market. The government in this regard has liberalized the mode of entry of FDI in order to give a boost to the domestic financial resource. This has been made possible further by abolishing the license and permit system since July 1991. Financial stability, with strong growth prospect, better inflation management and effective interest rate management has been a matter of attraction to foreign investors for the purpose of selecting India as a possible destination for their investment in potential sectors of Indian economy.

Besides, India provides a potential for the foreign institutions for their innovative production services in our country. For this purpose they are bringing in foreign capital and investible resources in select areas. We have examined here under some of the potential sectors in which such FDI inflow has taken place.
Telecom sector is one of them which is attractive to form players. In India the tele density as a parameter has been increasing by ifs and buts. As a result FDI has been coming in telecom players have come to India under the approval of Financial Investment Promotion Board (FIPB).

2.1 THEORY OF FDI:

Now we proceed to discuss about some of the theories pertaining to FDI developed by various economists during the last several decades. Some of those theories are discussed here under.

1) Eclecting theory of FDI and the OLI paradigm: This theory was developed by John Dunning at the University of Reading (UK) and Rutgers University (USA). The paradigm is a blend of three different theories of FDI = O + L + I

O = Ownership Advantages address the WHY question (why go abroad?). The WHY question hypothesizes that the Multinational Enterprise (MNE) has one or more firm specific advantages (ownership advantage, core competency) which allows it to overcome the costs of operating in a foreign country.
This firm specific advantage (FSA) is normally intangible and can be transferred within the multinational enterprise at low cost (e. g., brand name, benefits of economies of scale, technology). The advantage either generates higher revenues and/or lower costs that can offset the costs of operating at a distance in a foreign location.

**L = Location Advantages (Country Specific Advantages):** Location advantages address the WHERE question (locate where?). The motive to move offshore is to use the FSA in conjunction with factors in a foreign country. Through these factors (e. g., labour, land) the MNE makes profit (earns rents) on its FSAs. The choice of investment location depends on a complex calculation that includes economic, social and political factors.

**I = International Advantages:** Internalization advantages address the HOW question (how go abroad?). The MNE has various choices of entry mode, ranging from the market (arm’s length transactions) to the hierarchy (wholly owned subsidiary). The MNE chooses internalization (the internal route) where the market does not exist or functions poorly so that transactions costs of the external route are high.
This theory is elaborated hereunder.

**Firm Specific Advantages (The O Factor):** A multinational enterprise MNE) operating a plant in a foreign country is faced with additional costs compared to a local competitor in a domestic economy. The additional costs component has been attributed to the following:

a) Cultural, legal, institutional and language differences;

b) A lack of knowledge about local market conditions;

and

c) The increase expense of communicating and operating at a distance.

It has been gathered from the theory that an MNE although successful in domestic territory but may face severe competition and constraints while working on a foreign soil. John Dunning (University of Reading, UK) has therefore argued that either the MNE must be able to earn higher revenues for the same cost or have lower cost for the same revenues, than comparable to domestic firm. The theory concludes;

\[
\text{PROFIT} = \text{TOTAL REVENUES - TOTAL COST} - \text{COST OF OPERATING AT A DISTANCE}
\]

It has been argued that “cost of foreignness” is inevitable and hence the MNE has the option either to increase their revenues or reduce their
operating cost. In India this theory has been applied very successfully in respect of automobile sector and tele sector. The automobile sector companies, electronic machine companies are bringing sophisticated, state of the art technologies with their capital investment. They enjoy the advantage of cost & revenue with super technologies. This has enabled them to always enhance their revenues as compared to a domestic company.

**Country Specific Advantage (The L Factor):** A firm should consider external factors that influence the inflow of FDI in domestic economy. As a result the locational advantages of various countries are needed to be considered for allowing FDI. This kind of advantage is known as country specific advantage is denominated by L factor.

The country specific advantage can be categorized into three groups namely E, S and P representing Economic, Social and Political considerations.

- Economic advantages include quantities and qualities of factors of production. Size of the market projected consumer profile of the country, transport and communication cost involved, location of business units in special economic zones (SEZ), tax holidays granted in certain specific regions, government
subsidies such as raw material subsidy, transport subsidy, interest subsidy offered to some business units.

- Social advantages include psychic factors, mindset towards foreign institutional investors, cultural differences, linguistic differences, difference in terms of business ethics and level of business operation.

- Political factors include government policies, international production, global competition, interfirm trade practices; special incentive package provided to the foreign companies, some factors and concessions offered as a "level playing field" offered to the foreign corporate, recourse endowment factors are also considered for the purpose, double taxation avoidance facilities under double taxation avoidance agreement (DTAA) between inter the two sovereign authorities.

**Internalization Advantages (The I Factor):** It includes the production program carried on by the business enterprises on their own without collaborating under partnership joint venture or franchisee of an organization. The corporate in this context may venture upon its core competencies. The greater is the benefit of internalizing cross
border intermediate product markets, the more a corporate can venture into foreign production instead of depending on a license.

2.2 TYPES OF FDI:

The FDI in India can be classified as,

A. By Direction

B. By Target

C. By Motive

A. By Direction: In this category FDI is further divided into two, namely Inward FDI and Outward FDI.

a) Inward FDI: Inward FDI for an economy can be defined as the capital provided from a foreign direct investor residing in a country, to that economy, which is residing in another country. This study of impact of FDI in India relates to inward flowing FDI from different countries into India.

b) Outward FDI: If capital of one country is invested in foreign countries, the FDI is considered as outward FDI. In the context
of India, all the investments made by the home companies, outside India are outward FDI.

B. **By Target:** Under this type, FDI is classified as follows:

a) **Greenfield Investment:** The direct investment in new facilities or the expansion of existing facilities in foreign countries is termed as greenfield investment. This kind of investments are the primary objective of a host nation’s promotional efforts because they generate new production capacity and jobs, transfer technology and know-how, and can lead to linkages to the global market place. However, it often does this by crowding out local industry; multinationals are able to produce goods more cheaply because of advanced technology and efficient processes and uses up resources like labour, intermediate goods, etc. Another downside of greenfield investment is that profits from production do not feed back into the local economy, but instead to the multinational’s home economy. This is in contrast to local industries whose profits flow back into the domestic economy to promote growth. According to the World Investment Report 2008, a total number of 3,671 such greenfield FDI projects in India is recorded from 2003 to 2008 (first quarter of 2008).
b) **Brownfield Investments**: A related term to "Greenfield Investment" which is becoming popular is Brownfield Investment, where a site in advance used for a "un-clean" business purpose, such as a steel mill or oil refinery, is cleaned up and used for a less polluting purpose, such as commercial office space or a residential area.

The term "brownfields" came into use in 1992 year, at a U.S. congressional field hearing hosted by the Northeast Midwest Congressional Coalition.

c) **Mergers and Acquisitions**: Mergers and Acquisitions occurs when transfers of existing assets from local firms to foreign firms takes place. This is considered as the primary kind of foreign direct investments.

**Foreign** (or cross-border) **mergers** occur when the assets and operation of firms from different countries are integrated to establish a new legal entity. Mergers are the most common way for multinationals to do Foreign Direct Investment.

An acquisition may be defined as an act of acquiring effective control by one company over assets or management of another company without any combination of companies. Thus, in an
acquisition two or more companies may remain independent, separate legal entities, but there may be a change in control of the companies. When an acquisition is 'forced' or 'unwilling', it is called a takeover. In an unwilling acquisition, the management of 'target' company would oppose a move of being taken over. But, when managements of acquiring and target companies mutually and willingly agree for the takeover, it is called acquisition or friendly takeover. Unlike greenfield investment, acquisitions provide no long term benefits to the local economy - even in most deals the owners of the local firm are paid in stock from the acquiring firm, meaning that the money from the sale could never reach the local economy. Nevertheless, mergers and acquisitions are a significant form of Foreign Direct Investment. The following table provides a list of important merger and acquisition that took place in India.
Table 2.1: Selected Outbound M&A Transactions of over US$100 million (as of Mid 2008)

<table>
<thead>
<tr>
<th>Acquirer</th>
<th>Foreign target</th>
<th>Target Industry</th>
<th>Target Country</th>
<th>Approximate deal Value (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tata Steel Ltd.</td>
<td>Corus Group PLC</td>
<td>Steel</td>
<td>U.K.</td>
<td>14.85 billion</td>
</tr>
<tr>
<td>Hindalco Industries Ltd.</td>
<td>Novelis Inc.</td>
<td>Aluminium</td>
<td>Canada</td>
<td>6 billion</td>
</tr>
<tr>
<td>Sterlite Industries India Ltd.</td>
<td>Aserco Inc.</td>
<td>Mining</td>
<td>U.S.</td>
<td>2.6 billion</td>
</tr>
<tr>
<td>Tata Motors Ltd.</td>
<td>Ford Motors Co.'s Jaguar Limited and Land Rover Holdings</td>
<td>Automotive</td>
<td>U.K.</td>
<td>2.3 billion</td>
</tr>
<tr>
<td>Essar Steel Ltd.</td>
<td>Algoma Steel Inc.</td>
<td>Steel</td>
<td>Canada</td>
<td>1.57 billion</td>
</tr>
<tr>
<td>United Spirits Ltd.</td>
<td>Whyte and Mackay Ltd.</td>
<td>Food and Beverages</td>
<td>U.K.</td>
<td>1.18 billion</td>
</tr>
<tr>
<td>Tata Power Company Ltd.</td>
<td>30% stake each in PT Kaltim Prima Coal and PT Artumin Indonesia</td>
<td>Energy</td>
<td>Indonesia</td>
<td>1.1 billion</td>
</tr>
<tr>
<td>Tata Chemicals</td>
<td>General Chemical Industrial Products Inc.</td>
<td>Chemicals</td>
<td>U.S.</td>
<td>1.0 billion</td>
</tr>
<tr>
<td>Tata Sons Ltd.</td>
<td>30% stake in Energy-Brands Inc.</td>
<td>Food and Beverages</td>
<td>U.S.</td>
<td>677 million</td>
</tr>
<tr>
<td>Dr. Reddy's Laboratories Ltd.</td>
<td>Betepharm Arzneimittel GmbH</td>
<td>Pharmaceuticals</td>
<td>Germany</td>
<td>571 million</td>
</tr>
<tr>
<td>Company Name</td>
<td>Subsidiary Name</td>
<td>Industry/Technology</td>
<td>Location</td>
<td>Value (million)</td>
</tr>
<tr>
<td>--------------------------------------</td>
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</tr>
<tr>
<td>Wipro Technologies Ltd.</td>
<td>Infocrossing Inc.</td>
<td>Technology</td>
<td>U.S.</td>
<td>568</td>
</tr>
<tr>
<td>Suzion Energy Ltd. Through its subsidiary</td>
<td>Hansen Transmissions International NV</td>
<td>Industrial Machinery</td>
<td>Belgium</td>
<td>521</td>
</tr>
<tr>
<td>Ranbaxy Laboratories Ltd.</td>
<td>Terapia S.A.</td>
<td>Pharmaceuticals</td>
<td>Romania</td>
<td>324</td>
</tr>
<tr>
<td>Videocon Appliances Ltd.</td>
<td>Thomson Multimedia</td>
<td>Technology</td>
<td>France</td>
<td>292</td>
</tr>
<tr>
<td>Jubilant Organosys Ltd.</td>
<td>Draxis Health Inc.</td>
<td>Pharmaceuticals</td>
<td>Canada</td>
<td>258</td>
</tr>
<tr>
<td>Tata Coffee Ltd.</td>
<td>The Eight O' Clock Coffee Co.</td>
<td>Food and Beverages</td>
<td>U.S.</td>
<td>220</td>
</tr>
<tr>
<td>Aditya Birla Nuvo Ltd.</td>
<td>Minacs Worldwide Inc.</td>
<td>Technology</td>
<td>Canada</td>
<td>172</td>
</tr>
<tr>
<td>United Phosphorous Ltd.</td>
<td>Cerexagri S.A.</td>
<td>Chemicals</td>
<td>France</td>
<td>142</td>
</tr>
<tr>
<td>Subex System Ltd.</td>
<td>Azure Solutions Ltd.</td>
<td>Technology</td>
<td>U.K.</td>
<td>140</td>
</tr>
<tr>
<td>United Phosphorous Ltd.</td>
<td>Advanta Netherlands Holdings BV</td>
<td>Food and Beverages</td>
<td>Netherlands</td>
<td>119</td>
</tr>
</tbody>
</table>

From the above table, it is evident that a worth of huge amount have been struck in India till 2008. Following are the top 10 M&A deals in India till March, 2009:

1. **Tata Steel**’s mega takeover of European steel company **Corus Group PLC** for **$14.85** billion. The biggest ever for an Indian company. This is the first great deal which marked the arrival of India Inc. on the global stage.

2. **Vodafone**’s purchase of 52% stake in Hutch Essar for about **$10 billion**. Essar group still holds 32% in the Joint venture.

3. Hindalco of Aditya Birla group’s acquisition of Novellis for **$6 billion**.

4. **Ranbaxy**’s sale to Japan’s Daiichi for **$4.5 billion**. Sing brothers sold the company to Daiichi and since then there is no real good news coming out of Ranbaxy.

5. **ONGC** acquisition of Russia based **Imperial Energy** for **$2.8 billion**. This marked the turn around of India’s hunt for natural reserves to compete with China.

6. **NTT DoCoMo-Tata Tele services** deal for **$2.7 billion**. The second biggest telecom deal after the Vodafone. Reliance MTN deal if went through would have been a good addition to the list.
7. **HDFC Bank** acquisition of Centurion Bank of Punjab for $2.4 billion.

8. **Tata Motors** acquisition of luxury car maker **Jaguar Land Rover** for $2.3 billion. This could probably the most ambitious deal after the Ranbaxy one. It certainly landed Tata Motors into lot of trouble.

9. Wind Energy premier **Suzlon Energy**’s acquisition of **RePower** for $1.7 billion.

10. **Reliance Industries** taking over Reliance Petroleum Limited (RPL) for 8500 crores or $1.6 billion.

*Source*: ET

d) **Horizontal FDI**: In horizontal FDI, multi-plant firms duplicate roughly the same activities in multiple countries. In other words, it is an investment in the same foreign industry as a firm operates in at home.

e) **Vertical FDI**: It can take two forms:

1. backward vertical FDI: where an industry abroad provides inputs for a firm’s domestic production process
2. forward vertical FDI: in which an industry abroad sells the outputs of a firm's domestic production processes.

C. By Motive: Foreign Direct Investment also includes investments which based on the motive behind the investment from the perspective of the investing firm:

a) Market Seeking: Investments are targeted at either penetrating new markets or maintaining existing ones are termed as market seeking investments. Foreign Direct Investment of this type may also be employed as defensive strategy; it is argued that businesses are more likely to be pushed towards this kind of investment out of fear of losing a market rather than discovering a new one. This kind of Foreign Direct Investment can be distinguished by the foreign Mergers and Acquisitions in the 1980’s by Accounting, Advertising and Law firms.

Market-seeking investment is attracted by factors like host country's market size, per capita income and market growth. For firms, new markets provide a chance to stay competitive and grow within the industry as well as achieve scale and scope economies. Traditionally, market size and growth as FDI determinants related to
national markets for manufacturing products sheltered from international competition by high tariffs or quotas that triggered "tariff-jumping" FDI (UNCTAD, 1998, 107). Apart from market size and trade restrictions, MNEs might be prompted to engage in market-seeking investment, when their main suppliers or customers have set up foreign producing facilities and in order to retain their business they need to follow them overseas (Dunning, 1993, 58).

b) **Resource Seeking:** Investments which seek to acquire factors of production those are more efficient than those obtainable in the home economy of the firm are called resource seeking investments. Availability of natural resources, cheap unskilled or semi-skilled labor, creative assets and physical infrastructure promotes resource-seeking activities. Historically, the most important host country determinant of FDI has been the availability of natural resources, e.g. minerals, raw materials and agricultural products. Even when it was prominent as an FDI determinant, the presence of natural resources by itself was not sufficient for FDI to take place. Comparative advantage in natural resources usually gave rise to trade rather than to FDI. Investment took place when resource-abundant countries either lacked the large amounts of capital typically required for resource-extraction or did not
have the technical skills needed to extract or sell raw materials to the rest of the world. In addition, infrastructure facilities for getting the raw materials out of the host country and to its final destination had to be in place or needed to be created (UNCTAD, 1998).

Labour-seeking investment is usually undertaken by manufacturing and service MNEs from countries with high real labour costs, which set up or acquire subsidiaries in countries with lower real labour costs to supply labour intensive intermediate or final products. Frequently, to attract such production, host countries have set up free trade or export processing zones (Dunning, 1993).

c) Efficiency Seeking: Investments which firms hope will increase their efficiency by exploiting the benefits of economies of scale and scope, and also those of common ownership are known to be efficiency seeking investments. It is suggested that this kind of Foreign Direct Investment comes after either resource or market seeking investments have been realized, with the expectation that it further increases the profitability of the firm. Usually, this kind of Foreign Direct Investment is mostly widely practiced between developed economies; especially those within closely integrated markets (e.g. the EU).
The motivation of efficiency seeking FDI is to rationalize the structure of established resource based or market-seeking investment in such a way that the investing company can gain from the common governance of geographically dispersed activities. The intention of the efficiency seeking MNE is to take advantage of different factor endowments, cultures, institutional arrangements, economic systems and policies, and market structures by concentrating production in a limited number of locations to supply multiple markets (Dunning, 1993, 59). In order for efficiency seeking foreign production to take place, cross-border markets must be both well developed and open, therefore it often flourishes in regionally integrated markets (Dunning, 1993, 59).

2.3 HISTORY OF FDI IN INDIA:

At the time of independence, the attitude towards foreign capital was one of fear and suspicion. This was natural on account of the previous exploitative role played by it in 'draining away' resources from this country.

The suspicion and hostility found expression in the Industrial Policy of 1948 which, though recognizing the role of private foreign
investment in the country emphasized that its regulation was necessary in the national interest. Because of this attitude expressed in the 1948 resolution, foreign capitalists got dissatisfied and as a result, the flow of imports of capital goods got obstructed. As a result, the prime minister had to give following assurances to the foreign capitalists in 1949:

1. No discrimination between foreign and Indian capital. The government of India will not differentiate between the foreign and Indian capital. The implication was that the government would not place any restrictions or impose any conditions on foreign enterprise which were not applicable to similar Indian enterprises.

2. Full opportunities to earn profits. The foreign interests operating in India would be permitted to earn profits without subjecting them to undue controls. Only such restrictions would be imposed which also apply to the Indian enterprises.

3. Guarantee of compensation. If and when foreign enterprises are compulsorily acquired, compensation will be paid on a fair and equitable basis as already announced in government’s statement of policy.
Though the Prime Minister stated that the major interest in ownership and effective control of an undertaking should be in Indian hands, he gave assurance that there would be “no hard and fast rule in this matter.”

By a declaration issued on June 2, 1950, the government assured the foreign capitalists that they can remit the foreign investments made by them in the country after January 1, 1950. In addition, they were also allowed to remit whatever investment of profit and taken place.

Despite the above assurances, foreign capital in the requisite quantity did now flow into India during the period of the First plan. The atmosphere of suspicion had not changed substantially. However, the policy statement of the Prime Minister issued in 1949 and continued practically unchanged in the 1956 Industrial Policy Resolution, had opened up immense fields to foreign participation. In addition, the trends towards liberalization grew slowly and gradually more strong and the role of foreign investment grew more and more important.

The government relaxed its policy concerning majority ownership in several cases and granted several tax concessions for
foreign personnel. Substantial liberalization was announced in the New Industrial Policy declared by the government on 24th July-1991 and doors of several industries have been opened up for foreign investment.

Prior to this policy, foreign capital was generally permitted only in the those industries where Indian capital was scarce and was not normally permitted in those industries which had received government protection or which are of basic and/or strategic importance to the country. The declared policy of the government was to discourage foreign capital in certain inessential consumer goods and service industries.

However, this provision was frequently violated as a number of foreign collaborations even in respect of cosmetics, toothpaste, lipstick etc. were allowed by the government. It was also stated that foreign capital should help in promoting experts or substituting imports.

The government also laid down that in all those industries where foreign capital investment is allowed, the major interest in ownership and effective control should always be in Indian hands (this condition was also often relaxed).
The foreign capital investments and technical collaborations were required to be so regulated as to fit into the overall framework of the plans. In those industries where foreign technicians and managers were allowed to operate as Indians with requisite skills and experience were not available, vital importance was to be accorded to the training and employment of Indians in the quickest possible manner.

2.4 FDI SCENERIO DURING ECONOMIC REFORMS PERIOD:

Since July 24, 1991 during the regime of P. V. Narasingha Rao the new industrial policy (NIP) launched a program of integrating national economy with global economy. To meet the newer requirements the earlier FERA 1973 was replaced by Foreign Exchange Management Act (FEMA) 1999. This was necessary because of capital flight among the nations either for FDI or for Foreign Institutional Investment (FII). In 34 high priority industries FDI upto 51% is approved automatically subject to fulfillment of certain conditions. Companies engaged in export activities are allowed to attract 51% foreign equity. The new liberal FDI policy grants
freedom of location, choice of technology and repatriation of capital and dividend, subject to the provisions of FEMA 1999.

FDI Culture:

Many economists in the country have now realized the advantages of FDI to India. While the achievements of the Indian government are to be lauded, a willingness to attract FDI has resulted in what could be termed an “FDI Industry”. While researching the economic reforms on FDI, it was discovered that there exists a plethora of boards, committees, and agencies that have been constituted to ease the flow of FDI. A call to one agency about their mandate and scope usually results in the quintessential response to call someone else. Reports from FICCI and the Planning Commission place investor confidence and satisfaction at an all time high; citizens too deserve to be clued in on the government bodies are doing.

According to the current policy FDI can come into India in two ways. Firstly FDI up to 100% is allowed under the automatic route in all activities/sectors except a small list that require approval of the Government. FDI in sectors/activities under automatic route does not require any prior approval either by the Government or RBI. The investors are required to notify the Regional office concerned of RBI
within 30 days of receipt of inward remittances and file the required documents with that office within 30 days of issue of shares to foreign investors. All proposals for foreign investment requiring Government approval are considered by the Foreign Investment Promotion Board (FIPB). The FIPB also grants composite approvals involving foreign investment/foreign technical collaboration. As this clarity is useful for future investors, it has to be seen if these bodies are effective. The Initial research revealed four major bodies that have been constituted and could provide data pertaining to FDI

1991 Foreign Investment Promotion Board FIPB

• consider and recommend Foreign Direct Investment (FDI) proposals, which do not come under the automatic route. It is chaired by Secretary Industry (Department of Industrial Policy & Promotion).

1996 Foreign Investment Promotion Council FIPC

• constituted under the chairmanship of Chairman ICICI, to undertake vigorous investment promotion and marketing activities. The Presidents of the three apex business associations such as ASSOCHAM, CII and FICCI are members of the Council.
1999 **Foreign Investment Implementation Authority FIIA**

- functions for assisting the FDI approval holders in obtaining various approvals and resolving their operational difficulties. FIIA has been interacting periodically with the FDI approval holders and following up their difficulties for resolution with the concerned Administrative Ministries and State Governments.

2004 **Investment Commission**

- Headed by Ratan Tata, this commission seeks meetings and visits industrial groups and houses in India and large companies abroad in sectors where there was dire need for investment. Attempting to research directives and results of the above bodies resulted in no direct contact but instead a list of various other sub bodies.

- **Project Approval Board (PAB)** for approving foreign technology transfer proposals not falling under the automatic route.

- **Licensing Committee (LC)** for considering and recommending proposals for grant of industrial license.

- In addition, concerned Ministries/ Departments issue various approvals as per the allocation of business and various Acts being administered by them.
At the **State level**, State Investment Promotion Agency and, at the district level,

- **District Industries Centres**, generally look after projects.

- Concerned departments of the State Government handle sectoral projects.

- **Fast Track Committees (FTCs)** have been set up in 30 Ministries/Departments for close monitoring of projects with estimated investment of Rs. 100 crores and above and for resolution of issues hampering implementation.

- **“Investment Promotion and Infrastructure Development Cell”** gives further impetus to facilitation and monitoring of investment, as well as for better coordination of infrastructural requirements for industry

- **SIA** has been set up by the Government of India in the Department of Industrial Policy and Promotion in the Ministry of Commerce and Industry to provide a single window for entrepreneurial assistance, investor facilitation, receiving and processing all applications which require Government approval, conveying Government decisions on applications filed, assisting entrepreneurs and investors in setting up
projects, (including liaison with other organizations and State Governments) and in monitoring implementation of projects.

- **CCFI Cabinet Committee on Foreign Investment**- meets at the ministerial level and is guided by the prime Minister, considers foreign investment exceeding Rs 3 billion as requiring special political attention.

- **Indian Missions Abroad**- can also receive project proposal and will forward them to the institutions in New Delhi.

- **Indian Investment Centre**- (This was supposed to be closed after the Planning Commission was established but still continues to operate) established as an autonomous organization in 1960 with the objective of doing promotional work abroad to attract foreign private investment into India and establishment of joint ventures, technical collaborations and third country ventures between Indian and foreign entrepreneurs. The face of FDI usually resides with pamphlets and amalgamation of facts and figures that are circulated through many conferences. From these it can be deciphered that officially FDI policy is reviewed on an ongoing basis and measures for its further liberalization are taken. The 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 & Promotion. Policy announcement by SIA are subsequently notified by Reserve Bank of India (RBI) under Foreign Exchange Management Act (FEMA). Thus while clear procedures have been established for FDI, government needs to seriously evaluate how much resources and money is being poured to what is becoming the FDI industry. The fluidity of bodies has resulted in the monetary value of FDI feeding a makeshift industry that deals with dealing with the concept and procedures of FDI.

**CHRONOLOGY OF INDIA’S FINANCIAL LIBERALISATION SINCE 1991:**

**July 1991:** The government abolished the industrial licensing system, with a few exceptions, and approval for the expansion of large firms, including foreign firms, was no longer necessary. Foreign firms were allowed major shareholding in joint ventures, and foreign investment up to 51 per cent of equity in 35 priority industries received automatic approval. The new investment policy also spelled more incentives to attract FDI from non-resident Indians,
including 100 per cent ownership shares in many sectors and full repatriation of profits.

1992: The Security and Exchange Board of India (SEBI) Act was passed, and the SEBI has since been an independent regulator.

September 1992: Foreign institutional investors (FIIs) were given permission to participate in the Indian market. One FII could own up to 5 per cent of a firm and all FIIs combined could own 24 per cent. FIIs had to have at least 50 investors.

1994: The National Stock Exchange (NSE) began trading bonds in June and equity in November. Different features of the NSE include: equal access for all traders in a vast geographical area, a competitive market in security intermediation, electronic matching of trades, anonymous trading followed by guaranteed settlement, and a more independent corporate governance structure.
November 1996: "100 per cent debt FIIs" were permitted. These were allowed to buy corporate bonds, but not government bonds.

April 1997: The ceiling upon total ownership by all FIIs of a firm was raised from 24 per cent to 30 per cent. A shareholder resolution was required.

April 1998: FIIs were permitted to invest in government bonds, with a ceiling of USD 1 billion on all FIIs in aggregate.

June 1998: The ceiling on ownership by one FII in one firm was raised from 5 per cent to 10 per cent. FIIs were permitted to partially hedge currency exposure risk using the forward market. FIIs were permitted to trade equity derivatives in a limited way.

August 1999: The requirement that FIIs must have at least 50 investors was eased to 20.
February 2000: Foreign firms and individuals were allowed to access the Indian market through FIIs as “subaccounts”. Local fund managers were also permitted to manage funds for foreign firms and individuals through subaccounts. The requirement that no investor be allowed to own more than 5 per cent of an FII was eased to 10 per cent.

March 2000: The ceiling on total ownership by all FIIs of a firm was raised from 30 per cent to 40 per cent. A shareholder resolution was required.

March 2001: The ceiling on total ownership by all FIIs of a firm was raised from 40 per cent to 49 per cent. A shareholder resolution was required.

September 2001: The ceiling on total ownership by all FIIs of a firm was raised from 49 per cent to “the sectoral cap for the industry”. A shareholder resolution was required.

January 2003: Limitations on FII hedging using the forward currency market were removed.
December 2003: Approvals for FIIs at both the SEBI and the RBI were replaced by single approval at the SEBI.

November 2004: A new ceiling on total ownership by all FIIs of corporate bonds was placed at USD 0.5 billion.

February 2006: The ceiling on ownership of government bonds by all FIIs was raised to USD 2 billion. The ceiling on ownership of corporate bonds by all FIIs was raised to USD 1.5 billion.

Source: Lane and Schmukler (2007).

SOURCES OF FDI IN INDIA:

India has broadened the sources of FDI in the period of reforms. There were 120 countries investing in India in 2008 as compared to 15 countries in 1991. Thus the number of countries investing in India increased after reforms. After liberalization of economy Mauritius, South Korea, Malaysia, Cayman Islands and many more countries
U.K., Germany, Japan, Italy, and France which are not only the major investor now but during pre-liberalizations era also. The analysis in the following Table presents the major investing countries in India during 1991-2008. Mauritius is the largest investor in India during 1991-2008. FDI inflows from Mauritius constitute about 39.9% of the total FDI in India and enjoying the top position on India’s FDI map from 1995. This dominance of Mauritius is because of the Double Taxation Treaty i.e. DTAA- Double Taxation Avoidance Agreement between the two countries, which favours routing of investment through this country. This (DTAA) type of taxation treaty has been made out with Singapore also.

Table-2.2 MAJOR SOURCES OF FDI IN INDIA (1991-2008)

<table>
<thead>
<tr>
<th>Mauritius</th>
<th>USA</th>
<th>Singapore</th>
<th>UK</th>
<th>Netherlands</th>
<th>Japan</th>
<th>Germany</th>
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<td>4.4</td>
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<td>2.1</td>
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Source: Compiled & computed from the various issues of Economic Survey, RBI Bulletin, Ministry of Commerce
The US is the second largest investing country in India. While comparing the investment made by both (Mauritius and US) countries one interesting fact comes up which shows that there is a huge difference (between FDI inflows to India from Mauritius and the US) in the volume of FDI received from Mauritius and the US. FDI inflow from Mauritius is more than double then that from the US. The other major countries are Singapore with a relative share of 7.2% followed by UK, Netherlands, Japan, Germany, Cyprus, France, and Switzerland.

Thus, an analysis of last eighteen years of FDI inflows shows that only five countries accounted for nearly 66% of the total FDI inflows in India. India needs enormous amount of financial resources to carry forward the agenda of transformation (i.e. from a planned economy to an open market), to tackle imbalance in BOP, to accelerate the rate of economic growth and have a sustained economic growth.

2.5 FDI CONFIDENCE INDEX:

Attraction of foreign investment by a nation is a subject matter of confidence that nation enjoys from foreign capital providers.
That kind of confidence is generally referred to as FDI confidence index. The Foreign Direct Investment Confidence Index is a regular survey of global executives conducted by A.T. Kearney. The Index provides a unique look at the present and future prospects for international investment flows. Companies participating in the survey account for more than $2 trillion in annual global revenue. This survey “which tracks the impact of likely political, economic and regulatory changes on Foreign Direct Investment intentions and preferences of the leaders of the world’s leading companies”.

The following table depicts the FDI confidence index of 15 countries for different years.
Table 2.3: FDI Confidence Index

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Source: www.fdimagazine.com/news/fullstory.php (31.03.08)

(**) Indicates not among top 25 in the year’s index
China remains the top-ranked destination by foreign investors, a title it has held since 2002. The United States retakes second place from India, which had surpassed it in 2005. India, Brazil and Germany complete the top five favored investment destinations. Overall, developed economies rose in the Index as investors looked for safety. The most striking exception is the United Kingdom, whose reliance on financial services left it exposed in the current crisis. At the same time, the placement of China, India and Brazil in the top five shows a strong vote of confidence for the strength of these economies. Investors also expressed the most optimism about the future outlook for China, India and Brazil.

Having considered country wise FDI confidence index from 1998 to 2007, we can examine the shift in the confidence rate that has taken place in 2010 over 25 top FDI destinations. This confidence index has been depicted below:
Chart 1: 2010 FDI Confidence Index

Source: A. T. Kearney analysis 2010 - Foreign Direct Investment Confidence Index
For the first time, the three major emerging markets—China, India and Brazil—all ranked among the top four investment destinations as investors expect these countries to continue to deliver growth despite the economic crisis. Investors also reported the highest degree of optimism in the outlook for three countries, with nearly one-third seeing a more positive outlook for China (32 percent) and India (31 percent) compared to one year ago, and 22 percent saying Brazil’s outlook had improved. In contrast, investor outlook for the United States was decidedly more negative, with 22 percent of executives having more negative outlook for the country than a year ago.

China continued as number one in the Index and the distance between it and the next competitor, the United States, is larger than any of the subsequent gaps between countries in the ranking. FDI inflows to China in 2008 grew to $108.3 billion, up from $83.5 billion in 2007, and investment announcements reflect its continued attractiveness. Despite the positive investor outlook, India fell behind the United States to third in the ranking. While investors may have long-term confidence in the Indian economy, in times of economic uncertainty they prefer the more predictable and better-known destination. India
scored well across industries and was number one among nonfinancial services investors, however.

Brazil has been on an upward trajectory since 2004. Having grown robustly despite the severity of the global financial crisis, it has now reached the top five for the first time since 2001. “The emerging market giants China, India, and Brazil are gaining strength out of the crisis, as investors from all regions report strong confidence in their future outlook and see investments to these countries as indispensable to maintain competitiveness in tomorrow’s marketplace,” said Johan Gott, manager of the FDI Confidence Index.

2.6 POLICY PREFERENCE FOR FDI IN INDIA:

a) Industrial Policy

The Industrial Policy Resolution of 1956 and the statement on Industrial Policy of 1991 provide the basic framework for the overall policy in regard to the manufacturing industries. In the initial stages, industrial growth was regulated through grant of licenses, approvals, etc. The industrial policy announced in 1991 substantially dispensed with industrial licensing, announced measures facilitating foreign
investment and technology transfers, and threw open the areas so far reserved for the public sector.

The objective of this industrial policy is to:

a. maintain a sustained growth in productivity

b. enhance gainful employment

c. achieve optimal utilization of human resources

d. attain international competitiveness

e. transform India into a major partner and player in the global arena

With the objectives in focus, the government remains keen to deregulate Indian industry which will provide the freedom and flexibility in responding to market forces and alongside foster growth of the Indian industry.

b) Foreign Investment Policy

India’s investment policies are designed to attract significant capital inflows into India on a sustained basis and to encourage technology collaborations between Indian and foreign entities. Policy
initiatives taken over the last few years have resulted in inflows of foreign investments in diverse sectors of the economy.

a) Joint Ventures & Wholly Owned Subsidiaries

The FDI and all foreign exchange matters are regulated through the Foreign Exchange Management Act, 1998 FEMA. The National Industrial Classification 1987 is the basis for determining activities and classification for the purpose of FDI.

I) Automatic Route

Currently, FDI in all sectors or activities, except those specifically restricted, falls under the automatic route.

Automatic route does not require any prior approval either from the government or the RBI.

The company is required to simply inform the concerned regional office of the RBI on receiving remittance towards share application and post issuing shares to the foreign investor.

Investment in public sector units, as also for Export Oriented Units (EOU), Export Processing Zones (EPZ) and Software Technology Parks (STP) would be under the automatic route.
II) Restricted Areas for FDI

FDI is subject to an approval from the Government of India in the following cases

(i) Activities/items that require an Industrial License;

(ii) Proposals for acquisition of shares in an existing Indian company in financial services sector and where Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 is attracted.

(iii) All proposals exceeding the sectoral caps or in sectors where FDI is not permitted. There are ceilings on investment in certain sectors/activities. These limits are called sectoral caps and FDI is not permitted beyond specified caps, unless an approval is obtained. For instance, activity of publishing newspapers and periodicals (print media sector) is restricted by a sectoral cap of 26 per cent. Effectively, a foreign investor would be allowed to invest up to 26 per cent equity in the proposed print media business.

FDI policy is reviewed on an ongoing basis and changes in sectoral cap are notified through press notes by the SIA, Department of Industrial Policy & Promotion. FDI policy is also notified by the RBI.

FDI Permitted in Various Sectors/Activities:
- FDI PROHIBITED
  
i. Retail trading (except Single Brand Product retailing)

ii. Atomic energy

iii. Lottery business

iv. Gambling and betting sector

- FDI up to 26% allowed
  
i. Broadcasting
    
    (a) FM Radio – FDI + FII investment up to 20% with prior Government approval subject to guidelines by Ministry of Information & Broadcasting.

    (b) Uplinking a news and current affairs TV Channel – up to 26% (FDI + FII) with prior FIPB approval.

ii. Print media: Publishing newspaper and periodicals dealing with news and current affairs – FDI up to 26% with prior Government approval

iii. Defence industries – FDI up to 26% with prior Government approval

iv. Insurance – Foreign equity (FDI+FII) up to 26% under the automatic route

v. Petroleum and Natural Gas Sector – Refining in case of PSUs: up to 26% with prior FIPB approval.
- **FDI up to 49% allowed**

  i. Broadcasting

  a. Setting up hardware facilities such as up-linking, HUB, etc.- FDI+FII equity up to 49% with prior Government approval subject to up-linking Policy notified by Ministry of Information & Broadcasting.

  b. Cable network- Foreign equity (FDI+FII) up to 49% with prior Government approval subject to Cable Television Network Rules (1994) notified by Ministry of Information & Broadcasting.

  c. DTH - Foreign equity (FDI+FII) up to 49% with prior Government approval. FDI cannot exceed 20% subject to guidelines by Ministry of Information & Broadcasting.

  ii. Domestic Scheduled Passenger Airline Sector - FDI up to 49% under the automatic route with no direct or indirect participation of foreign airlines.

  iii. Asset reconstruction companies – up to 49% (only FDI) with prior FIPB approval.

  iv. Petroleum refining by PSUs. No divestment of domestic equity in existing PSUs would be permitted for increasing the FDI up to 49%.
v. Commodity exchanges – FDI + FII up to 49% with a sub-limit for FII at 23% and for FDI at 26%.

vi. Stock exchanges – FDI + FII up to 49% with a sub-limit for FII at 23% and for FDI at 26%.

vii. Credit Information Companies- FDI + FII up to 49% with a sub-limit for FII at 24% in the CICs listed on the Stock Exchanges.

- Sectors where FDI up to 51% is allowed
  Single Brand product retailing- with prior Government approval subject to:-
  a) Products being sold under the same brand internationally.
  b) Products sold being of a single brand. Retailing of multiple products sold under different brand names, even if produced by the same manufacturer, would not be allowed.
  c) Single Brand product retailing would cover only such products as are branded at the manufacturing point.

- FDI up to 74% allowed
  i. Telecommunication services: basic and cellular – FDI up to 74% allowed. FDI up to 49% is under automatic
route. Beyond 49% and upto 74% requires FIPB approval. Foreign equity includes FDI, FII, NRI, FCCBs, ADRs, GDRs, convertible preference shares, and proportionate foreign equity in Indian promoters/Investing Company.

ii. ISP with gateways, radio-paging, end-to-end bandwidth – FDI up to 74% with FDI beyond 49% requiring prior Government approval

iii. Establishment and operation of satellites - FDI up to 74% with prior Government approval.

iv. Private sector banks - Foreign equity (FDI + FII) up to 74% under the automatic route.

v. Non-Scheduled airlines, Chartered airlines - FDI up to 74% under the automatic route subject to no direct or indirect participation by foreign airlines.

vi. Cargo airlines and Ground handling- FDI up to 74% allowed under the automatic route.

vii. Private sector banks - Foreign equity (FDI + FII) up to 74% under the automatic route
FDI up to 100% allowed subject to conditions

i. Development of Existing Airports – FDI up to 74% under automatic route and beyond this under FIPB route

ii. Exploration and mining of coal and lignite for captive consumption – FDI up to 100% under automatic route subject to provisions of Coal Mines (Nationalization) Act, 1973

iii. Trading: Trading of items sourced from small scale sector under Govt approval route

iv. Trading: Test marketing of such items for which a company has approval for manufacture under Govt approval route

v. Courier services for carrying packages, parcels and other items which do not come within the ambit of the Indian Post Office Act, 1898.- prior Government approval subject to existing laws and subject to existing laws and exclusion of activity relating to distribution of letters, which is exclusively reserved for the State.
vi. Tea Sector, including tea plantation - prior
    Government approval subject to divestment of 26%
equity within five years

vii. Non Banking Finance Companies – FDI up to 100%
    under the automatic route subject to minimum
capitalization norms

viii. Construction Development projects- FDI up to 100%
    on the automatic route subject to minimum
capitalization norms; minimum area development and
    lock-in on original investment.

ix. ISP without gateway, infrastructure provider
    providing dark fibre, right of way, duct space,
tower (Category I); electronic mail and voice mail –
    FDI up to 49% under automatic route. Beyond
    49% and upto 100% subject to FIPB approval
    subject to divestment of 26% equity in 5 years if the
    investing companies are listed in other parts of the
    world.

x. Domestic Scheduled/ Non-Scheduled & Chartered
    airlines/Air transport services – NRI investment up to
100% permitted under the automatic route with no direct or indirect participation of foreign airlines.

xi. **Power trading** – up to 100% subject to compliance with Regulations under the Electricity Act, 2003;

xii. **Cigars & Cigarettes** – up to 100% with prior FIPB approval and Subject to industrial license under the Industries (Development & Regulation) Act, 1951.

xiii. **Alcohol distillation and brewing** - 100% FDI under automatic route subject to license by appropriate authority.

*Source: www.dipp.gov.in*

### III) Approval Route

FDI in activities not covered under the automatic route requires prior government approval. Applications are considered by the FIPB which is a specially empowered board chaired by the Secretary, Ministry of Finance. Composite proposals involving foreign investment and foreign technical collaboration are also considered by the FIPB. Application for FDI cases, except NRI investments and EOUs, are to be submitted with the FIPB Unit, Department of Economic Affairs, Ministry of Finance situated at New Delhi.
Once an Indian company has the foreign investment approval from the FIPB, they do not require any further clearance from the RBI to receive inward remittance or to issue shares to the foreign investors. The company is simply required to inform the concerned regional office of the RBI on receiving remittance towards share application and issuing shares to the foreign investor.

Technology Agreements

For promoting technological competitiveness of the Indian industry, acquisition of foreign technology is encouraged. Foreign technology includes technical know-how, design and drawing, engineering service and royalty. Payments for royalty and lump sum fee for transfer of technology are permitted under automatic route i.e. without any approval of the Government of India, subject to Foreign Exchange Management (Current Account Transactions) Rules, 2000 as amended from time to time. The royalty payments are 'net of taxes' and are calculated on the basis of the net ex-factory sale price i.e. sale price of the product less excise duties, cost of the standard bought-out components and the landed cost of imported components (irrespective of the source of procurement) including ocean freight, insurance and custom duties.
Use of Trademarks and Brand Name

Payment of royalty for use of trademarks and brand-name are also allowed under automatic route without any ceiling. Royalty on brand name or trademark is to be calculated on net sales i.e. gross sales less agent/dealer commission, transport cost including ocean freight, insurance, duties, taxes and other charges, and cost of raw materials, parts and components imported from the foreign licensor or its subsidiary/affiliated company.

Technology and Trademark Agreements - Specific Approval

The following cases of technology agreements or trademark usage will require a specific government approval

1. Royalty payments in respect of sectors or activities which are subject to the approval route are considered by the Project Approval Board (PAB) in the Department of Industrial Policy and Promotion, Ministry of Commerce & Industry.

2. Proposals where both financial and technical collaboration are proposed are considered by the FIPB.
2.7 PROCEDURE OF ENTRY OF A FOREIGN COMPANY IN INDIA:

FDI for virtually all items/activities can be brought in through the Automatic Route under powers delegated to the Reserve Bank of India (RBI), and for the remaining items/activities through Government approval. Government approvals are accorded on the recommendation of the Foreign Investment Promotion Board (FIPB).

AUTOMATIC ROUTE

(a) New Ventures

All items/activities for FDI/NRI/OCB investment up to 100% fall under the Automatic Route except those covered under (i) to (iv) of para under Government Approval.

Whenever any investor chooses to make an application to the FIPB and not to avail of the automatic route, he or she may do so.

Investment in public sector units as also for EOU/EPZ/EHTP/STP units would also qualify for the Automatic Route. Investment under the Automatic Route shall continue to be governed by the notified sectoral policy and equity caps and RBI will ensure compliance of the same. The National Industrial Classification
(NIC) 1987 shall remain applicable for description of activities and classification for all matters relating to FDI/NRI/OCB investment:

Areas/sectors/activities hitherto not open to FDI/NRI/OCB investment shall continue to be so unless otherwise decided and notified by Government.

Any change in sectoral policy/sectoral equity cap shall be notified by the Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy & Promotion.

(b) Existing Companies

Besides new companies, automatic route for FDI/NRI/OCB investment is also available to the existing companies proposing to induct foreign equity. For existing companies with an expansion programme, the additional requirements are that (i) the increase in equity level must result from the expansion of the equity base of the existing company without the acquisition of existing shares by NRI/OCB/foreign investors, (ii) the money to be remitted should be in foreign currency and (iii) proposed expansion programme should be in the sector(s) under automatic route. Otherwise, the proposal would need Government approval through the FIPB. For this the proposal
must be supported by a Board Resolution of the existing Indian company.

For existing companies without an expansion programme, the additional requirements for eligibility for automatic approval are
(i) that they are engaged in the industries under automatic route,
(ii) the increase in equity level must be from expansion of the equity base and
(iii) 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.

The automatic route for FDI and/or technology collaboration would not be available to those who have or had any previous joint venture or technology transfer/trade mark agreement in the same or allied field in India.

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.

In a major drive to simplify procedures for foreign direct investment under the “automatic route”, RBI has given permission to Indian Companies to accept investment under this route without obtaining prior approval from RBI. Investors are required to notify the Regional Office concerned of the RBI of receipt of inward remittances within 30 days of such receipt and file required documentation within 30 days of issue of shares to Foreign Investors. This facility is available to NRI/OCB investment also.

GOVERNMENT APPROVAL

For the following categories, Government approval for FDI/NRI/OCB through the FIPB shall be necessary: -

I. All proposals that require an Industrial Licence which includes (1) the item requiring an Industrial Licence under the Industries (Development & Regulation) Act, 1951; (2) foreign investment being more than 24 per cent in the equity capital of units manufacturing items reserved for small scale industries; and (3) all items which require an
Industrial Licence in terms of the locational policy notified by Government under the New Industrial Policy of 1991.

II. All proposals in which the foreign collaborator has a previous venture/tie up in India. The modalities prescribed in Press Note No. 18 dated 14.12.1998 of 1998 Series, shall apply to such cases. However, this shall not apply to investment made by multilateral financial institutions such as ADB, IFC, CDC, DEG, etc. as also investment made in IT sector.

III. All proposals relating to acquisition of shares in an existing Indian company in favour of a foreign/NRI/OCB investor.

IV. All proposals falling outside notified sectoral policy/caps or under sectors in which FDI is not permitted. Areas/sectors/activities hitherto not open to FDI/NRI/OCB investment shall continue to be so unless otherwise decided and notified by Government. Any change in sectoral policy/sectoral equity cap shall be
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. Such 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.

For greater transparency in the approval process, Government has announced guidelines for consideration of FDI proposals by the FIPB.

ISSUE AND VALUATION OF SHARES IN CASE OF EXISTING COMPANIES

Allotment of shares on preferential basis shall be as per the requirements of the Companies Act, 1956, which will require special
resolution in case of a public limited company. In case of listed companies, valuation shall be as per the RBI/SEBI guidelines as follows:

The issue price shall be either at:

a) The average of the weekly high and low of the closing prices of the related shares quoted on the Stock Exchange during the six months preceding the relevant date or

b) The average of the weekly high and low of the closing prices of the related shares quoted on the Stock Exchange during the two weeks preceding the relevant date. The stock exchange referred to is the one at which the highest trading volume in respect of the share of the company has been recorded during the preceding six months prior to the relevant date.

The relevant date is the date thirty days prior to the date on which the meeting of the General Body of the shareholder is convened.

In all other cases a company may issue shares as per the RBI regulation in accordance with the guidelines issued by the erstwhile Controller of Capital Issues. Other relevant guidelines of Securities and Exchange Board of India (SEBI)/(RBI) including the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997, wherever applicable, would need to be followed.
Foreign Investment in the Small Scale Sector

Under the small scale policy, equity holding by other units including foreign equity in a small scale undertaking is permissible up to 24 per cent. However there is no bar on higher equity holding for foreign investment if the unit is willing to give up its small scale status. In case of foreign investment beyond 24 per cent in a small scale unit which manufactures small scale reserved item(s), an industrial license carrying a mandatory export obligation of 50 per cent would need to be obtained.

FOREIGN INVESTMENT POLICY FOR TRADING ACTIVITIES

Foreign investment for trading can be approved through the automatic route up to 51% foreign equity, and beyond this by the Government through FIPB. For approval through the automatic route, the requirement would be that it is primarily export activities and the undertaking concerned is an export house/trading house/ super trading house/star trading house registered under the provisions of the Export and Import policy in force.

OTHER MODES OF FOREIGN DIRECT INVESTMENTS

Global Depository Receipts (GDR)/American Deposit Receipts (ADR)/Foreign Currency
Convertible Bonds (FCCB): Foreign Investment through GDRs/ADRs, Foreign Currency

Convertible Bonds (FCCBs) are treated as Foreign Direct Investment. Indian companies are allowed to raise equity capital in the international market through the issue of GDR/ADRs/FCCBs.

These are not subject to any ceilings on investment. An applicant company seeking Government’s approval in this regard should have a consistent track record for good performance (financial or otherwise) for a minimum period of 3 years. This condition can be relaxed for infrastructure projects such as power generation, telecommunication, petroleum exploration and refining, ports, airports and roads.

There is no restriction on the number of GDRs/ADRs/FCCBs to be floated by a company or a group of companies in a financial year. A company engaged in the manufacture of items covered under Automatic Route, whose direct foreign investment after a proposed GDR/ADR/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.
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 use requirements; in addition, 25 per cent of the FCCB proceeds can be used for general corporate restructuring.

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. The following guidelines apply to issue of such shares:

(i) Foreign investment in preference share is considered as part of share capital and fall outside the External Commercial Borrowing (ECB) guidelines/cap.

(ii) 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. If the preference shares are structured without such conversion option, they would fall outside the foreign direct equity cap.

(iii) 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.
(iv) The dividend rate would not exceed the limit prescribed by the Ministry of Finance.

(v) Issue of Preference Shares should conform to guidelines prescribed by the SEBI and RBI and other statutory requirements.

INVESTMENT BY NON RESIDENT INDIANS & OVERSEAS CORPORATE BODIES

For all sectors, excluding those falling under Government approval, NRIs (which also includes PIOs) and OCBs (an overseas corporate body means a company or other entity owned directly or indirectly to the extent of at least 60% by NRIs) are eligible to bring investment through the automatic route of RBI. All other proposals, which do not fulfill any or, all of the criteria for automatic approval are considered by the Government through the FIPB.

The NRIs and OCBs are allowed to invest in housing and real estate development sector, in which foreign direct investment is not permitted. They are allowed to hold up to 100 percent equity in civil aviation sector in which otherwise foreign equity only up to 40 percent is permitted.
FOREIGN TECHNOLOGY AGREEMENTS

With a view to injecting the desired level of technological dynamism in Indian industry and for promoting an industrial environment where the acquisition of technological capability receives priority, foreign technology induction is encouraged both through FDI and through foreign technology collaboration agreements. Foreign technology collaborations are permitted either through the automatic route under delegated powers exercised by the RBI, or by the Government. However, cases involving industrial licenses/small scale reserved items do not qualify for automatic approval and would require consideration and approval by the Government. Automatic route for technology collaboration would also not be available to those who have, or had any previous technology transfer/trade-mark agreement in the same or allied field in India.

AUTOMATIC APPROVAL

The Reserve Bank of India, through its regional offices, accords automatic approval to all industries for foreign technology collaboration agreements subject to (i) the lump sum payments not exceeding US $ 2 Million; (ii) royalty payable being limited to 5 per
...cent for domestic sales and 8 per cent for exports, subject to a total payment of 8 per cent on sales over a 10 year period; and (iii) the period for payment of royalty not exceeding 7 years from the date of commencement of commercial production, or 10 years from the date of agreement, whichever is earlier (The aforesaid royalty limits are net of taxes and are calculated according to standard conditions).

Payment of royalty up to 2% for exports and 1% for domestic sales is allowed under automatic route on use of trademarks and brand name of the foreign collaborator without technology transfer. In case of technology transfer, payment of royalty subsumes the payment of royalty for use of trademark and brand name of the foreign collaborator. Royalty on brand name/trade mark shall be paid as a percentage of net sales, viz., gross sales less agents’/dealers’ commission, transport cost, including ocean freight, insurance, duties, taxes and other charges, and cost of raw materials, parts, components imported from the foreign licensor or its subsidiary/affiliated company.

Payment of royalty up to 8% on exports and 5% on domestic sales by wholly owned subsidiaries (WOS) to offshore parent companies is allowed under the automatic route without any restriction on the duration of royalty payments.
GOVERNMENT APPROVAL

For the following categories, Government approval would be necessary:

(a) Proposals attracting compulsory licensing

(b) Items of manufacture reserved for the small scale sector

(c) Proposals involving any previous joint venture or technology transfer/trademark agreement in the same or allied field in India. The definition of "same" and "allied" field would be as per 4 digit NIC 1987 Code and 3 digit NIC 1987 Code.

(d) Extension of foreign technology collaboration agreements (including those cases, which may have received automatic approval in the first instance)

(e) Proposals not meeting any or all of the parameters for automatic approval as given in paragraph above.

The items of foreign technology collaboration, which are eligible for approval through the automatic route, and by the Government are technical know-how fees, payment for design and drawing, payment for engineering service and royalty.

Payments for hiring of foreign technicians, deputation of Indian technicians abroad, and testing of indigenous raw material, products, and indigenously developed technology in foreign countries are
governed by separate RBI procedures and rules and are not covered by the foreign technology collaboration approval. Similarly, payments for imports of plant and machinery and raw material are also not covered by the foreign technology collaboration approval. For any of these items, entrepreneurs may contact the RBI.

100% EXPORT ORIENTED UNITS/ EXPORT PROCESSING ZONES/ SPECIAL ECONOMIC ZONES

100 per cent Export Oriented Units (EOUs) and units in the Export Processing Zones (EPZs)/Special Economic Zones (SEZs), enjoy a package of incentives and facilities, which include duty free imports of all types of capital goods, raw material, and consumables in addition to tax holidays against export.

100% FDI is permitted under automatic route for setting up of industrial park/industrial model town/special economic zone in the country. To encourage investment in this sector, 100% income tax exemption for 10 years within a block of 15 years is also granted for the industrial parks set up during the period 1.4.1977 to 31.3.2006".
Automatic Approval

The Development Commissioners (DCs) of Export Processing Zones (EPZs) /Free Trade Zones (FTZS)/Special Economic Zones (SEZs) accord automatic approval to projects where

a) Activity proposed does not attract compulsory licensing or falls in the services sector except IT enabled services;
b) Location is in conformity with the prescribed parameters;
c) Units undertake to achieve exports and value addition norms as prescribed in the Export and Import Policy in force;
d) Unit is amenable to bonding by customs authorities; and

e) Unit has projected the minimum export turnover, as specified in the Handbook of Procedures for Export and Import.

All proposals for FDI/NRI/OCB investments in EOU/EPZ units qualify for approval through automatic route subject to sectoral norms. Proposals not covered under the automatic route would be considered and approved by FIPB.

Conversion of existing Domestic Tariff Area (DTA) units into EOU is also permitted under automatic route, if the DTA unit satisfies the parameters mentioned above and there is no outstanding export
obligation under any other Export Oriented scheme of the Government of India.

FDI up to 100% is allowed through the automatic route for all manufacturing activities in Special Economic Zones (SEZs), except for the following activities:

- arms and ammunition, explosives and allied items of defence equipments, defence aircraft and warships;
- atomic substances;
- narcotics and psychotropic substances and hazardous chemicals;
- distillation and brewing of alcoholic drinks; and
- cigarettes/cigars and manufactured tobacco substitutes.

For services, norms as notified, would be applicable

Government Approval

All proposals which do not meet any or all of the parameters for automatic approval will be considered and approved by the Board of Approval of EOU/EPZ/SEZ set up in the Department of Commerce.
ELECTRONIC HARDWARE TECHNOLOGY PARK AND SOFTWARE TECHNOLOGY PARK SCHEMES

In order to provide impetus to the electronics industry, to enhance its export potential and to develop an efficient electronic component industry, Electronic Hardware Technology Park (EHTP) and Software Technology Park (STP) schemes offer a package of incentives and facilities like duty free imports on the lines of the EOU Scheme, deemed exports benefits and tax holidays.

AUTOMATIC APPROVAL

The Directors of STPs in respect of STP proposals; and the Designated Officers in respect of EHTP proposals accord automatic approval if:

a) items do not attract compulsory licensing;

b) location is in conformity with the prescribed parameters;

c) export obligation laid down in the respective EHTP scheme or STP scheme is fulfilled;
d) unit is amenable to bonding by the Customs, and all the manufacturing operations are carried out in the same premises and the proposal does not envisage sending out of the bonded area any raw material or intermediate products for any other manufacturing or processing activity.

All proposals for FDI/NRI/OCB investments in EHTP/STP units are eligible for approval through Automatic Route subject to parameters listed under para given above [For procedure to obtain Automatic Approval].

GOVERNMENT APPROVAL

All proposals which do not meet any or all of the parameters for automatic approval need to be considered and approved by the Government. Government approval for FDI/NRI/OCB investment under EHTP/STP needs to be obtained through the FIPB in respect of proposals covered under paragraph given above [For procedure to obtain Government approval].
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:

i. Automatic Route

FDI up to 100 per cent is allowed under the automatic route in all activities/sectors except where the provisions of the consolidated FDI Policy, paragraph on 'Entry Routes for Investment' issued by the Government of India from time to time, are attracted.

FDI in sectors /activities to the extent permitted under the automatic route does not require any prior approval either of the Government or the Reserve Bank of India.

ii. 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, Ministry of Finance. Application can be made in Form FC-IL, which can be downloaded from http://www.dipp.gov.in. Plain paper
applications carrying all relevant details are also accepted. No fee is payable.

Indian companies having foreign investment approval through FIPB route do not require any further clearance from the Reserve Bank of India for receiving inward remittance and for the issue of shares to the non-resident investors.

The Indian company having received FDI either under the **Automatic route** or the **Government route** is required to report in the Advance Reporting Form, the details of the receipt of the amount of consideration for issue of equity instrument viz. shares / fully and mandatorily convertible debentures / fully and mandatorily convertible preference shares through an AD Category –I Bank, together with copy/ies of the FIRC evidencing the receipt of inward remittances along with the Know Your Customer (KYC) report on the non-resident investors from the overseas bank remitting the amount, to the Regional Office concerned of the Reserve Bank of India within 30 days from the date of receipt of inward remittances.

Further, the Indian company is required to issue the equity instrument within 180 days, from the date of receipt of inward remittance or debit to NRE/FCNR (B) account in case of NRI/PIO.
After issue of shares / fully and mandatorily convertible debentures / fully and mandatorily convertible preference shares, the Indian company has to file the required documents along with Form FC-GPR with the Regional Office concerned of the Reserve Bank of India within 30 days of issue of shares to the non-resident investors.

2.8 CAUSES AND REASONS FOR LOW FDI IN INDIA

Here we have discussed some of the weakness and constraints on achieving higher FDI inflows into India. Not all are relevant to every originating country or every destination sector. Some factors are more relevant for first time investors with no previous experience of investment in India. The review presents broad generalisations based on the perceptions of potential foreign investors and independent consultants who interact closely with them. Some of the factors mentioned, may be based on past experience that is no longer valid because of recent improvements.

A. IMAGE AND ATTITUDE:

Though economic reforms welcoming foreign capital were introduced in the nineties it does not seem so far to be really evident in
our overall attitude. There is a lingering perception abroad that foreign investors are still looked at with some suspicion. There is also a view that some unhappy episodes in the past have a multiplier effect by adversely affecting the business environment in India. Besides the “Made in India” label is not conceived by the world as synonymous with quality. When a foreign investor considers making any new investment decision, it goes through four stages in the decision making process and action cycle, namely, (a) screening, (b) planning, (c) implementing and (d) operating and expanding. The biggest barrier for India is at the first, screening stage itself in the action cycle. “Often India looses out at the screening stage itself” (BCG). This is primarily because we do not get across effectively to the decision-making “board room” levels of corporate entities where a final decision is taken. Our promotional effort is quite often of a general nature and not corporate specific.

India is, moreover, a multi-cultural society and a large number of multinational companies (MNC) do not understand the diversity and the multi-plural nature of the society and the different stakeholders in this country. Though in several cases, the foreign investor is discouraged even before he seriously considers a project, 220 of the
Fortune 500 companies have some presence in India and several surveys (JBIC, Japan Exim bank, A T Kearney) show India as the most promising and profitable destination.

On the other hand China is viewed as 'more business oriented,' its decision making is faster and has more FDI friendly policies (ATK 2001). Despite a very similar historical mistrust of foreigners and foreign investment arising from colonial experience, modern (post 1980 China) differs fundamentally from India. Its official attitude to FDI, reflected from the highest level of government (PM, President) to the lowest level of government bureaucracy (provinces) is one of consciously enticing FDI with a warm welcome. They recognise the multifaceted and mutual benefits arising from FDI.

All investments, foreign and domestic are made under the expectation of future profits. The economy benefits if economic policy fosters competition, creates a well functioning modern regulatory system and discourages 'artificial' monopolies created by the government through entry barriers. A recognition and understanding of these facts can result in a more positive attitude towards FDI.
B. POLICY FRAMEWORK:

Most of the problems for investors arise because of domestic policy, rules and procedures and not the FDI policy per se or its rules and procedures. The FDI policy, which has a lot of positive features, is summarised first, before highlighting the domestic policy related difficulties that are commonly the focus of adverse comment by investors and intermediaries.

a) FDI POLICY:

India has one of the most transparent and liberal FDI regimes among the emerging and developing economies. By FDI regime we mean those restrictions that apply to foreign nationals and entities but not to Indian nationals and Indian owned entities. The differential treatment is limited to a few entry rules, spelling out the proportion of equity that the foreign entrant can hold in an Indian (registered) company or business. There are a few banned sectors (like lotteries & gaming and legal services) and some sectors with limits on foreign equity proportion. The entry rules are clear and well defined and equity limits for foreign investment in selected sectors such as telecom quite explicit and well known.
Most of the manufacturing sectors have been for many years on the 100 per cent automatic route. Foreign equity is limited only in production of defence equipment (26 per cent), oil marketing (74 per cent) and government owned petroleum refineries (26 per cent). Most of the mining sectors are similarly on the 100 per cent automatic route, with foreign equity limits only on atomic minerals (74 per cent), coal & lignite (74 per cent), exploration for oil (51 per cent to 74 per cent) and diamonds and precious stones (74 per cent). 100 per cent equity is also allowed in non-crop agro-allied sectors and crop agriculture under controlled conditions (e.g. hot houses).

In the case of infrastructure services, there is a clear dichotomy. While highways and roads, ports, inland waterways and transport, and urban infrastructure and courier services are on the 100 per cent automatic route, telecom (49 per cent), airports (74 per cent), civil aviation (40 per cent) and oil and gas pipelines (51 per cent) have foreign equity limits. India also has a clear policy of FDI in services, with 100 per cent automatic entry into many services such as construction, townships/resorts, hotels, tourism, films, IT/ISP/email/voice mail, business services & consultancy, renting and leasing, VCFs and VCCs, medical/health, education, advertising and wholesale
trade. The financial intermediation section has sectoral caps like banking (49 per cent), insurance (26 per cent), as do some services like professional services (51 per cent).

Subject to these foreign equity conditions a foreign company can set up a registered company in India and operate under the same laws, rules and regulations as any Indian owned company would. Unlike many countries including China, India extends National Treatment to foreign investors. There is absolutely no discrimination against foreign invested companies registered in India or in favour of domestic owned ones. There is however a minor restriction on those foreign entities who entered a particular sub-sector through a joint venture with an Indian partner. If they (i.e. the parent) want to set up another company in the same sector it must get a no-objection certificate from the joint-venture partner. This condition is explicit and transparent unlike many hidden conditions imposed by some other recipients of FDI.

There are also a few prudential conditions on the sale of shares in unlisted companies and the above market price sale of shares in public companies.
b) DOMESTIC POLICY:

The domestic policy framework affects all investment, whether the investor is Indian or foreign. To an extent, foreign companies or investors that have set up an Indian company or Joint Venture have become indigenised and thus can operate more or less competitively with other Indian company. They adjust themselves to the milieu. This is not, however, true of foreign direct investors who are coming into India for the first time. To the uninitiated the hurdles look daunting and the complexity somewhat perplexing.

Among the policy problems that have been identified by surveys as acting as additional hurdles for FDI are laws, regulatory systems and Government monopolies that do not have contemporary relevance. Illustratively, the outdated Food Price Order (FPO) and Prevention of Food Adulteration Act are a major hurdle for FDI in food processing. The latter makes even a technical or minor violation subject to criminal liability. As a Task force had recommended some years ago, that we need to formulate a single integrated Food Act (including weights & measures). This should also make provision for a modern Food Regulatory system with a single integrated regulator. Based on the announcement in the last budget a Group of Ministers has been
constituted to evolve a modern food law. The Essential Commodities Act adds to the difficulty of entering the food processing industry by making the procurement, storage and transport of agricultural produce subject to many vagaries and undermining the competitive advantage that India possesses. The Central government has recently taken steps to reduce the ambit of this act and eliminate controls on movement and storage of food grain. Initial steps have also been taken in the direction of putting this act into suspended state to be invoked only by a Central government notification to be applied only to well-specified emergency conditions like drought, floods and other natural disasters for a specific area and duration. Other simplification measures announced in the last budget were the amendment of the Milk and Milk products Control Order to remove restrictions on milk processing capacity, decanalisation of the export of agricultural commodities and phasing out of remaining export controls, expansion of futures and forward trading to cover all agricultural commodities and amendment to the Agriculture Produce Marketing Acts to enable farmers to sell directly to potential processors.

Similarly labour laws discourage the entry of green field FDI because of the fear that it would not be possible to downsize if and when there is a downturn in business. Labour laws, rules and
procedures have led to deterioration in the work culture and the comparative advantage that is even beginning to be recognised by responsible Trade Unions. Pursuant to the announcement in the 2001-02 budget that labour laws would be reformed, a Group of Ministers was set up to work out the modalities. The Labour Commission has in the meanwhile also submitted its report. The Group of Ministers will suggest specific changes in the laws for the approval of the Cabinet. SSI reservations further limit the possibility of entering labour intensive sectors for export. Dereservation of readymade garments during the year 2000 and de-reservation of fourteen other items related to leather goods, shoes and toys during 2001 is a welcome development. About 10 per cent of the items on the list of items reserved for the small-scale sector have been freed over the past few years. These two policy constraints are particularly relevant for export oriented FDI. More flexible labour laws that improve work culture and enhance productivity and SSI de-reservations will help attract employment generating FDI inflows of the kind seen in South East Asia in the seventies and eighties and in China since the nineties.

The Urban Land Ceiling Acts and Rent Control Acts in States are a serious constraint on the entire real estate sector. This is another sector that has attracted large amounts of FDI in many countries
including China. Like the labour-intensive industrial sectors it can also generate a large volume of productive employment. These Acts need to be repealed if a construction boom is to be initiated that would reverse the decline in overall investment, attract FDI, generate employment and make rental accommodation available to the poor. The Centre has already repealed the Urban Land Ceiling Act but each State has to issue a notification to repeal the Act in that State. Rent Control is a State subject and each State would have to reform its Rent control Act. The Central government has set up an Urban Reform Facility to provide funds to States that repeal the State Land Ceiling Act, reform the Rent Control Act and carry out other urban reforms.

Weak credibility of regulatory systems and multiple and conflicting roles of agencies and government has an adverse impact on new FDI investors, which is greater than on domestic investors. All monopolists have a strong self-interest in preventing new entrants who can put competitive pressure. In the past, government monopoly in infrastructure sectors has slowed down policy reform. FDI was discouraged by the fear that pressure exerted by government monopolies through their parent departments would bias the regulatory system against new private competitors. As regulatory systems and procedures move up the learning curve, initial problems stemming
from lack of regulatory knowledge/experience in sectors such as Telecom have been gradually overcome. Similarly, in the past, strategy and implementation problems connected with dis-investment created great uncertainty and increased policy/ regulatory risk, resulting in a lack of interest of FDI investors in bidding for these companies. With a much clearer strategy and effective implementation over the past year and a half, there should be better inflow on this account.

According to some consultants, in the banking sector, controls on activity dampen FDI inflows. It is alleged that persistent fears of impending “fiscal crisis” is another constraint, and that a well articulated strategy for medium term fiscal consolidations would address these concerns. The absence of product patents in the chemicals sector has reduced inflows into the drugs and pharmaceuticals sector.

Though the foreign trade and tariff regime for Special Export Zones (SEZs) approximates a genuine free trade zone, the other elements of the policy framework and procedures remain virtually the same as in the Domestic Tariff Area. The SEZs are therefore still not fully on par with the Export Zones of China with respect to Labour Intensive production.
C. PROCEDURES:

According to Boston Consulting Group, investors find it frustrating to navigate through the tangles of bureaucratic controls and procedures. McKinsey (2001) found that, the time taken for application/bidding/approval of FDI projects was too long. Multiple approvals, excessive time taken (2-3 years) such as in food processing and long lead times of up to six months for licenses for duty free exports, lead to “loss of investors’ confidence despite promises of a considerable market size.”

Bureaucracy and red tape topped the list of investor concerns as they were cited by 39 per cent of respondents in the A T Kearney survey. Of the three stages of a project, namely general approval (e.g. FDI, investment licence for items subject to licence), clearance (project specific approvals e.g. environmental clearance for specific location and product) and implementation, the second was the most oppressive. Three-fourth of the respondents in the survey indicated that (post-approval) clearances connected with investment were the most affected by India’s red tape. According to a CII study, a typical power project requires 43 Central Government clearances and 57 State Government level (including the local administration) clearances. Similarly, the
numbers of clearances for a typical mining project are 37 at the Central Government level and 47 at the State Government level. Though the number of approvals/clearances may not always be much lower in the OECD countries such as the USA and Japan the regulatory process is transparent with clear documentation requirements and decision rules based largely on self-certification, and generally implemented through the legal profession.

The Government has set up an inter-ministerial Committee to examine the existing procedures for investment approvals and implementation of projects and suggest measures to simplify and expedite the process for both public and private investment. The Committee, which was set up in September 2002, has submitted Part I of its report (dealing with Public sector projects) to the Government, which is under examination. A sub-Group of the Committee is specifically looking into simplification of procedures relating to private investment. The respondents of the ATK survey also indicated that the divide between Central and State governments in the treatment of foreign investors could undermine the FDI promotion efforts of the Central Government. The FICCI (2001) study similarly cites centre-state duality as creating difficulties at both the approval and project implementation stages. These studies find that the bureaucracy in
general is quite unhelpful in extending infra-structural facilities to any project that is being set up. This leads to time and cost overruns. At an operational level, multiple returns have to be filed every month. One effect of these bureaucratic delays is the low levels of realization of FDI inflows vis-à-vis the proposals cleared (CII). Although the realization rate has improved to 45 per cent in 2000-01 compared to 21 per cent in 1997, it remains a matter of concern. The precise reason for the low levels of realization is the post approval procedures, which has in the past played havoc with project implementation.

FIPB:

It should be noted, that the delays mentioned by foreign investors are not at the stage of FDI approval per se i.e. at the entry point whether through RBI automatic route or FIPB approval. The FIPB considers application on the basis of notified guidelines and disposes them within a 6-8 week timeframe, as has been laid down by the Cabinet. The entire process of FIPB applications, starting from their registration through to listing on FIPB agenda and their final disposal and despatch on official communication is placed on the website, which adds to the transparency of decision-making and enhances investor confidence.
Similarly, the underlying advisory support in the form of online chat facility and dedicated email facility for existing and prospective investors has created an investor friendly image. A FICCI Study on, “Impediments to Investment” (January 2002) has acknowledged that the Central level FIPB clearances have been successfully streamlined. The FIPB approval system has also been rated as world class by independent surveys conducted by CII and JICA.

The FIIA framework has also been strengthened recently by adoption of a six-point strategy. These includes close interaction with companies at both operational and board room level, follow up with administrative ministries, State Governments and other concerned agencies and sector specific approach in resolving investment related problems. The major implementation problems are encountered at the state level, as project implementation takes place at the state level. FICCI in its study on “Impediments to Investment” has observed that the Regional meetings for foreign investors under the FIIA chaired by the Industry Secretary are now turning out to be problem-solving platforms.
D. QUALITY OF INFRASTRUCTURE:

Poor infrastructure affects the productivity of the economy as a whole and hence its GDP/per capita GDP. It also reduces the comparative advantage of industries that are more intensive in the use of such infrastructure. In the context of FDI, poor infrastructure has a greater effect on export production than on production for the domestic market. FDI directed at the domestic market suffers the same handicap and additional costs as domestic manufacturers that are competing for the domestic market. Inadequate and poor quality roads, railroads and ports, however raise export costs vis-a-vis global competitors having better quality and lower cost infrastructure. As a foreign direct investor planning to set up an export base in developing/emerging economies has the option of choosing between India and other locations with better infrastructure, India is handicapped in attracting export oriented FDI.

Poor infrastructure is found to be the most important constraint for construction and engineering industries. “Law, rules, regulations relating to infrastructure are sometimes missing or unclear e.g. LNG and the power sector is beset with multiple problems such as State monopoly, bankruptcy and weak regulators” (McKinsey 2001).
E. STATE OBSTACLES:

Taxes levied on transportation of goods from State to State (such as octroi and entry tax) adversely impact the economic environment for export production. Such taxes impose both cost and time delays on movement of inputs used in production of export products as well as in transport of the latter to the ports. Differential sale and excise taxes (States and Centre) on small and large companies are found to be a deterrent to FDI in sectors such as textiles (McKinsey 2001). Investments that could raise the productivity and quality of textiles and thus make them competitive in global markets remain unprofitable because they cannot overcome the tax advantage given to small producers in the domestic market.

Globally the service sector received 43 per cent of total investment in emerging markets in 1997 (ATK 2001). As this is a State subject, the States have to take the lead in simplifying and modernising the policy and rules relating to this sector.

In market determined exchange rate, this is reflected in an exchange rate that is more depreciated than it would be if infrastructure was efficient.
These costs have been quantified by the CII-World Bank study of Investment environment in India and its comparison with similar World Bank studies on China and other countries.

At the local level (sub-state) issues pertaining to land acquisition, land use change, power connection, building plan approval are sources of project implementation delay. The State level issues are also being considered by the Govindarajan committee with a view to seeing how they can be alleviated.

F. LEGAL DELAYS:

Though India’s Anglo Saxon legal system as codified is considered by many legal experts to be superior to that of many other emerging economies it is often found in practice to be an obstacle to investment. One of the reasons is the inordinate delay are the interlocutory procedures that characterise judicial procedures. As a result the “Rule of law,” which has often been cited as one of the attractive features of the Indian economy for foreign investors, is found to be a significant positive factor by only 3 per cent for FDI in India. In contrast, 26 per cent of all those surveyed by ATK (2001) cited this as an important factor in their global investment decisions.