CHAPTER ONE

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CHAPTER 1

NON-RESIDENT INVESTMENT - AN OVERVIEW

Non-resident investment or investments in a country by aliens is quite a common phenomenon in most underdeveloped/developing countries. Such investments have, generally, given a shot in the arm to industrial development in the host country and paved the way for the establishment of large, stable, industrial empires.

1.1 Foreign participation in Indian industry

Indian industry too has received a fair measure of support and backing from non-residents. One cannot but recognise the immense contribution to the growth of our industry by several large foreign business houses - to name a few Andrew Yule, Jessop, Braithwaite, General Motors, Ford Motors, Bird and Company, Martin Burn, Balmer Laurie, Gladstone Lyall, Imperial Tobacco, I.C.I., Remington Rand, IBM, Lever Bros, Lipton and Brooke Bond. Many of these organisations started in India as trading firms before turning to assembly and manufacture of a range of capital and consumer goods.

Participation of non-residents in Indian business and trade may, broadly speaking, take one of two forms -- a) direct investment in cash or (rarely) in kind or b) sale of technology, drawings or industrial property rights. The modalities of acquisition of foreign technical know-how or patents and trade marks through various types of collaboration agreements are not discussed here since under such arrangements there is no foreign investment as such; on the other hand these arrangements envisage Indian investment in foreign know-how etc.,
Foreign investment, accompanied by import of technology, is preferable to technical collaboration sans equity, in as much as:

i) it encourages higher productivity and expeditious implementation;

ii) it ensures long term interest in the project and transfer of technological developments, including the benefits of Research and Development;

iii) it makes available modern managerial and marketing skills, so essential for tapping international markets;

iv) it encourages buy back of products and

v) it could lead to further co-operation between the two partners through expansion or diversification.

Areas in which foreign investment may be welcome, according to the Confederation of Engineering Industry, are

a) development of infrastructural facilities in energy, transportation, roads etc;

b) electronics and telecommunication;

c) manufacture of energy efficient equipment and computers.

1.2 Government policy towards foreign investment

Foreign investment in India is subject to guidelines framed by the Government of India (GOI) from time to time in line with its industrial policy. Appendix I of the GOI's Industrial Licensing Policy of 1973 (ILP 1973), which has been amended from time to time, details the fields of manufacturing activity open to companies with foreign equity.
in excess of 40%. Foreign equity investment in such industries is generally allowed on a selective basis in the context of the need to promote and channelise investment into the priority sectors of the economy and thereby generate the desired level of exports, employment etc.

Approved non-resident investments in India are governed by the provisions of the Foreign Exchange Regulation Act, 1973 (FERA) which came into force on 1st January, 1974 and the Exchange Control Manual of the Reserve Bank of India (RBI), the authority empowered to administer FERA.

When FERA came into force, all companies having a foreign equity in excess of 40% had to seek the approval of the RBI to carry on their existing trading, commercial or industrial activities in India. The RBI framed certain guidelines for disposal of such carry-on business applications under Sec. 29 of the Act. These guidelines provide a clue to the Government's thinking in the matter of foreign equity investment. Briefly, foreign equity to the extent of 74% is permitted in cases where the activities of a company under Appendix I of ILP 1973 together with activities requiring sophisticated technology and exports, account for not less than 75% of its total annual turnover. Where this condition is not met and where such turnover is at least 60%, a foreign equity of 51% may be permitted with an export obligation of 10% tagged on to it. In all other cases, the permitted level of foreign equity is just 40%.
A few multinational companies which found the RBI's guidelines unacceptable, being against their Corporate policy, had to close down their business in India. These included IBM World Trade Corporation and Coca-Cola Export Corporation both of them based in the United States of America. Some of them which were permitted a foreign equity of 51% voluntarily diluted it to 40% as they were unwilling to sign the compulsory export undertaking.

Various methods were employed by the FERA companies to dilute their foreign equity in accordance with the RBI’s directives. The most common method was raising additional capital either by a public offer or by a rights issue to the Indian shareholders. Some disinvested a part of their foreign equity and offered it to the Indian public.

FERA companies are subject to a host of other restrictions in their business activities under Sections 26, 29 and 31 of FERA. These restrictions pertain to borrowings, taking up agencies or acting as technical representatives and acquisition and holding of immovable property. All these activities require the prior approval of the RBI.

While FERA companies are not allowed to cross the limits of Appendix I of ILP 1973 a non-FERA company or a company with a foreign equity not exceeding 40% is treated by the GOI on par with any other Indian Company in the matter of its expansion/diversification programmes.
1.3 FERA merits a review

The FERA was enacted more than fifteen years ago. Its main objective was to encourage indigenisation and discourage foreign equity/technical collaboration in those areas where there was no need to maintain a high level of equity participation. This restrictive approach merits an indepth review in the interests of an accelerated growth rate and the need to keep pace with rapid technological developments taking place all over the world. The growth rate in our country has remained static at an average of 3% per annum as against the annual increase in the population of 2.2%; the net growth is thus hardly 1% per annum.

1.3.1 Foreign investments - are they harmful?

Let us now pause for a moment to examine the 'dangers' of foreign investment often talked about by the proponents of a restrictive foreign investment policy. The main concerns expressed are

a. outflow of precious foreign exchange by way of dividends and
b. control of Indian companies passing into foreign hands.

According to a Reserve Bank of India study on foreign collaborations in industry during the period 1977-78 to 1980-81, "The aggregate average annual remittance in foreign exchange, comprising dividends, royalties, technical fees, interest on foreign loans and other remittances to foreign collaborators amounted to Rs. 70 crores. Dividend was the largest single item and formed 47%. On an average these aggregate remittances formed 1% of the total value of
production of the private sector companies covered in the survey. In the absence of such production the country would have to import the items". Thus the apprehension regarding huge outflows of foreign exchange is groundless.

As for control, restricting foreign investment to 40% of equity capital by itself does not ensure that the reigns of power remain in Indian hands. Experience has shown that under the present pattern of shareholding and with certain safeguards in the Articles even a 40% stake ensures adequate control to the foreigners. As a matter of fact with an equity of just 26% the alien will be able to effectively block the passage of important special resolutions, like those relating to amendments to Memorandum and Articles, issue of additional capital and intercorporate investments and loans exceeding certain limits.

1.3.2 Foreign investment vis-a-vis the Eighth Plan (1990-1995)

The Eighth Plan envisages a higher growth rate at 6%. This will require a massive dose of investment. According to one estimate, a total of Rs. 1,45,450 crores will be required during the Eighth Plan period to finance investment in the private corporate sector alone. This includes foreign funds of the order of Rs. 21,818 crores or Rs. 4,364 crores per annum. Assuming a debt-equity ratio of 5:1, the share of Direct Foreign Investment (DFI) would average Rs. 727 crores per annum, as against Rs. 240 crores of DFI approved in 1988. If the debt-equity ratio is taken at 2:1, the requirement of DFI comes to an astounding figure of Rs. 1454
crores per annum. Thus there is an urgent need for the planners and the government to envisage a greater role for DFI in the country's development efforts than hitherto. Indeed, with a substantial reservoir of skilled manpower, low wages and a large market, India is better placed to attract foreign investment than many other countries. Yet foreign investment in India averages a meagre Rs. 100 crores a year, as against Rs. 2,000 crores in Socialist China and Rs. 1500 crores per annum in the ASEAN (The Association of South East Asian Nations) countries.

1.3.3 Ways and means to attract foreign capital

It should be realised that state-of-the-art technology is closely guarded and is, therefore, likely to be passed on/updated only if the overseas partner has an adequate stake in the project. Unless competitive terms and conditions are offered we may not succeed in attracting foreign investment and with it the latest, sophisticated technology. The guidelines relating to foreign investment and technology transfer need therefore to be liberalised. As long as the technology is current and not repetitive and the terms of collaboration are, prima facie, competitive and reasonable, the exact proportion of foreign equity should be left to entrepreneurial negotiations, subject to final approval of the Government. Similarly, it is insane to treat all technologies alike and offer a maximum of 5% royalty. Indian business may find it difficult to acquire advanced technology unless it is willing to pay an appropriate price for it.
Government should restrict itself to defining the broad parameters of foreign collaborations, leaving the details to the commercial judgement of the parties.

1.3.4 Free trade zones

To attract foreign technology and investment, the Government has lately identified six Free Trade Zones (FTZ), at Kandla (Gujarat), Santacruz (Bombay), NOIDA (U.P), Cochin (Kerala), Meenambaccam (Madras) and Falta (Calcutta), exclusively for 100% export-oriented units (EDUs). Industrial undertakings set up in these FTZs are required to export 75% of their production; the balance 25% may be sold in the domestic market.

Units set up in the FTZs may have a foreign equity of 100% provided the minimum value added is 30%. The incentives enjoyed by the FTZ units include:

a. complete income tax holiday for the first five years;
b. duty free imports of capital goods, raw materials and components under Open General Licence (O.G.L.);
c. exemption from central excise duty and other central levies on finished goods and
d. permission to repatriate the capital invested and the profits/dividends earned thereon, at any time.

1.4 Recent policy relaxations

That the Government is keen to encourage direct foreign investment is clear from the fact that 'fast track' facilities have been extended to Japan and West Germany, two of the world's most buoyant economies. Certain other measures introduced recently, like allowing industrial
licences or foreign collaboration approvals to be issued in the name of the foreign company if it has incorporated a company in India to implement a project approved by the Government are also a pointer to the Govt.'s revised policy regarding foreign investments. Steps like these seem to have given a boost to foreign investments in India as can be gauged from the fact that investments approved in the year 1988 aggregated Rs. 240 crores as against Rs. 107 crores in 1987.

1.4.1 The Pepsi-Cola and Coca-Cola projects
The recent clearance of the Rs. 22 crore Pepsi-Cola project, a joint venture of Pepsi-Cola International, Punjab Agro Industries Corporation and Voltas Limited also demonstrates the direction of the Govt.'s new thinking in the matter of foreign investment. This decision of the Govt. has, however, come in for sharp criticism. Where is the need for foreign expertise in a low priority area like soft drinks? Is this not a case of misplaced priority?

Government has stoutly defended its stand by pointing out to the enormous export earnings anticipated from this project. It is believed that 75% of the output will be exported to Pepsi Cola's concentrate manufacturing plants in Europe and elsewhere in the world. The projected exports in the 10th year are Rs. 195 crores. It remains to be seen as to whether this commitment will be met and what action Government will initiate for a default, if any.
Close on the heels of the Pepsi project, and naturally so, came the Coca Cola project. The scheme was so devised - a 100% foreign owned unit at the NOIDA FTZ - that the Government was obliged to give it a detailed scrutiny before deciding to discard it, albeit for reasons not entirely convincing. The last word, however, is yet to be said on this project.

1.4.2 Policy towards NRIs

Govt.'s policy towards Non-Resident Indians (NRIs) underwent a sea change in the early eighties. The main objectives of the revised policy are

a) tapping the large reserves of funds held by NRIs abroad (no reliable estimate is available though it is reliably learnt that there are over 10 million NRIs and persons of Indian origin living all over the world) so as to step up the country's foreign exchange reserves and

b. helping the NRIs establish industries within the country and thereby utilising their entrepreneurial and professional skills for the country's own development. Towards this end the Government has, in the last seven years, offered various concessions, benefits and incentives to NRIs besides simplifying and rationalising rules and procedures for them. What are these special measures and what has been their impact? These are discussed in the remaining chapters of this research study.