Government Policy and Foreign Investment in India

2.1 Introduction

In terms of nature of investment both domestic investors and foreign investors differ from one another resulting in a sort of compulsion on the part of the foreign counterparts to follow certain rules and regulations while intending to invest in the host country. Government policy affects foreign investment in a more vigorous manner especially in a forward-looking progressive economy like Indian than domestic investment. This is so because of the vulnerability of implications of the investment drawn from abroad on the various growth prospects of the country. Given the diversity of objectives and urge for fast development, it is commonly believed that in a developing economy like India, government policies governing foreign investment is quite crucial. Thus, the present chapter broadly outlines the various government policies for foreign capital in general and Foreign Direct Investment (FDI) and Foreign institutional investment (FII) in particular. This is attempted with a view to relating the FDI and FII policies of the government with their governance structure which ultimately helps prepare a strong ground to further the study on implications of foreign investment on the economic growth in general and that on corporate performance in specific.

When policies are discussed pertaining to the effect of FDI on performance, it makes sense for a brief retrospection of the subject tracing its chronicles. In nut shell, policies influencing foreign investment thereby directing growth in Indian in the pre and post reform periods are of utter importance.
2.2 Foreign Investment Policy in Pre-Reform India

India achieved its independence on 15th August, 1947 and since then it has come a long way. It is now considered as one of the strongest emerging economies of the world. Like most of the developing nations, it followed a path of self reliant development and the strategy as a whole was based on public investment as an engine for growth (Jadhav, 2004). The first thirty years post –independence recorded the country’s economy growing at the rate of mere 3.6 per cent marking per capita growth of 1.6 per cent per year (Acharya, 2007).

During the time the government maintains a strong hold on the economic activities taking place and too a large extent protected the domestic players from the intense global competition. The FDI policy in place at that time came with a lot of restriction for the foreign companies. Only a limited number of companies were authorized to have an equity share of more than 40 per cent which therefore made them apprehensive in bringing their finest technologies to India. The economy was deprived of foreign capital and foreign technology and thus internationally proficient scales and quality of production could not be maintained (Beena et al, 2007).

The Indian trade policy concentrated mainly on import substitution which meant that it attempted to reduce its foreign dependency through the local production of industrialized products. There were vast restrictions on imports and the commodities which could be imported had high tariffs attached to it. This further meant that the cost of producing an output for Indian producers was very high and therefore probably made them uncompetitive in the global market for the very reason. Along with the manufacturing sector, the financial sector was also not very effective. It hardly focused upon creating adequate capital from inside as well as outside the country. It was extensively controlled by the government which took most of the decisions regarding loans and price control. In fact most of the banks during the first three decades after independence were owned by the government. This ensured that any decision by the financial sector had to go through the government and no activity could take place without its approval. All these factors deprived the sectors of the main characteristics that determine the growth, which are competition, research and development activities and overall efficiency. It not only made the process of work much lengthier but it also made it more stressful as the government interference was immense and existed in there day to day operation.
Other sectors such as agriculture and allied were also growing at a very slow rate of 2.5 per cent and compared to the other sectors such as industry and services the growth rate was the lowest. Considering the fact that agriculture contributed almost sixty per cent towards the national income the growth rate was disgraceful. But nonetheless we saw a tremendous change in the growth rate after reforms bringing it to 4.7 per cent which is almost double. It is to note that the decade of 1980's saw an encouraging growth in the various sectors of the economy. According to the above table all the three sectors above in the table as well as the overall GDP grew almost one third. The GDP and the GDP per capita of the country grew from 3.6 per cent and 1.4 per cent to 5.6 to 3.4 per cent respectively. This growth was a consequence of various factors such as industrial and trade liberalization as well as the tax reforms during the period (Shankar Acharya, 2007). Even the industry and the service sector rose to 7.1 and 6.7 per cent respectively.

Although the situation had improved from the early decades, the country was still in major problems as the economy was facing growing structural imbalance. A large part of India’s investment was financed by private savings, however by the second half of 1980’s growth in private savings was very hard and consequently during the time India became quite dependent on borrowing from foreign sources. This further led to the much known balance of payment crisis in 1991. The current deficit had amounted to more than 2 per cent (Jadhav, 2004) and along with that the inflation rate had reached an all time high of 9.1 % making it intolerable for the normal person (Wadhva, 2007). In order to resolve the matter the government was left with no choice but to agree to economic liberalization and thus came the famous economic reforms of 1991.

2.3 Foreign Investment Policy in Post-Reform India

The year of 1991 was a remarkable year for India as it totally changed the way the whole world perceived the country. It was the year in which the economic reforms took place and as a result brought the world much closer to the country. A new industrial policy was formulated by the finance minister Mr. Man Mohan Singh which led to de-licensing of industry and also various obligations of approvals and licenses for investment and expansion were put an end for all with an exception of 18 industries (Beena et al, 2007).
This resulted in reduction of bureaucratic practices considerably and made the enterprises much more independent in making their decisions regarding various aspects of work.

The transformation in corporate transaction began with the new reforms too placed at sectored level in the economy. The financial sector went through a total turn around as a result of these reforms. The liberalized and free approach seized for various decisions regarding the activities of the bank. The private sector was also allowed without much restriction in order to enter the financial sector; this made the sector much more competitive and thus efficient. On the other hand the manufacturing sector also saw the fruits of the economic reforms, there was a sudden increase in the demand for goods as the import tariffs were reduced and the nation had opened up for the whole world to take a piece of it. It was now easier for the foreign companies to enter into the market as the FDI policy was liberalized and various restrictions on portfolio and direct investment were removed. The technology transfer were made easier and the royalty payment were reduced significantly, this showed the way to a new era of both financial and technical collaboration between enterprises in India and the rest of the world.

Agriculture and allied, industry and services all grew from the respective rates to 4.7, 7.6 and 7.6 respectively between 1992/93-1996/97. At the same time the GDP also increased from 5.6 per cent in1982-1991 to 6.7 per cent in 1992-1978. This showed that the economy reacted positively to the economic reforms. The productivity had gained as a result of deregulation of trade and finance and the export had grown at a tremendous rate of 20 per cent (in dollar terms) for three continues years after the reform attributing to the considerable devaluation in real effective terms and free policy regime for industry, foreign trade and payments (Acharya,2007).
### Table -2.1 Foreign Direct investment and Balance of Payment Indicators

<table>
<thead>
<tr>
<th>Year</th>
<th>FDI/GDP</th>
<th>FDI/Export</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>0.05</td>
<td>0.74</td>
</tr>
<tr>
<td>1992-93</td>
<td>0.12</td>
<td>1.78</td>
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<tr>
<td>1993-94</td>
<td>0.21</td>
<td>2.63</td>
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<tr>
<td>1994-95</td>
<td>0.41</td>
<td>5.09</td>
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<tr>
<td>1995-96</td>
<td>0.60</td>
<td>6.78</td>
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<tr>
<td>1996-97</td>
<td>0.73</td>
<td>8.49</td>
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<tr>
<td>1997-98</td>
<td>0.86</td>
<td>10.14</td>
</tr>
<tr>
<td>1998-99</td>
<td>0.59</td>
<td>7.43</td>
</tr>
<tr>
<td>1999-2000</td>
<td>0.48</td>
<td>5.88</td>
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<tr>
<td>2000-01</td>
<td>0.87</td>
<td>9.04</td>
</tr>
<tr>
<td>2001-02</td>
<td>1.28</td>
<td>14.0</td>
</tr>
<tr>
<td>2002-03</td>
<td>0.99</td>
<td>9.56</td>
</tr>
<tr>
<td>2003-04</td>
<td>0.71</td>
<td>6.75</td>
</tr>
<tr>
<td>2004-05</td>
<td>0.86</td>
<td>7.17</td>
</tr>
<tr>
<td>2005-06</td>
<td>1.10</td>
<td>8.64</td>
</tr>
<tr>
<td>2006-07</td>
<td>2.40</td>
<td>17.36</td>
</tr>
</tbody>
</table>

Source: RBI Bulletin, Various Issues

Besides the above the linkage of absolute flow of FDI in various years with the GDP and export shows the significant role of FDI in the growth of Indian economy. The analysis
and comparison of Percentage of FDI to gross domestic product and exports of India can be examined. This analysis and comparison would give the true picture of the role of foreign direct investment for the growth of Indian economy. The above Table 2.1 depicts that foreign direct investment as a percentage of gross domestic products were only 0.05 percent in 1991-92, and it went up to 0.86 percent in 1997-98. But during 1999-2000, it declined to 0.48 and later went up to 2.40 percent in 2006-07. Similarly foreign direct investment as a percentage of follows the same pattern. Started with 0.74 percent in 1991-92, went up to 10.14 with marginal increase and again fell down to 5.88 in the year 1999-2000. With ups and down it again stood at 17.36 in 2006-07. The above data, in not wholly, but to a large extent speaks about the importance of foreign investment in the process of growth in India.

Foreign investment flow in to a country emanates from four broad sources such as Foreign Institutional Investment (FII), NRI Investment, Global Depository Receipts (GDRs) and Foreign Direct Investment (FDI). A brief exploration of the policies related to all the above four foreign investment sources is presented below with a view to understand the strength of government initiative towards attracting foreign investment in to the country.

2.3.1 FII Policy

While presenting the Budget for 1992-93, the Finance Minister Dr. Manmohan Singh had announced a decision to allow reputed foreign investors, such as Pension Funds etc., to invest in India capital market. To operationalise this policy announcement, it has become necessary to evolve guidelines for such investments by Foreign Institutional Investors (FIIs).

The following guidelines have been formulated in this regard.

1. Foreign Institutional Investors (FIIs) including institutions such as Pension Funds, Mutual Funds, Investment Trusts, Asset Management Companies, Nominee Companies and Incorporated/Institutional Portfolio Managers or their power of attorney holders (providing discretionary and non-discretionary
portfolio management services) and non-discretionary portfolio management services) would be welcome to make investments under these guidelines.

2. FIIs would be welcome to invest in all the securities traded on the Primary and Secondary markets, including the equity and other securities/instruments of companies which are listed/to be listed on the Stock Exchanges in India including the OTC Exchange of India. These would include shares, debentures, warrants, and the schemes floated by domestic Mutual Funds. Government may even like to add further categories of securities later from time to time.

3. FIIs would be required to obtain an initial registration with Securities and Exchange Board of India (SEBI), the nodal regulatory agency for securities markets, before any investment is made by them in the Securities of companies listed on the Stock Exchanges in India, in accordance with these guidelines. Nominee companies, affiliates and subsidiary companies of a FII will be treated as separate FIIs for registration, and may seek separate registration with SEBI.

4. Since there are foreign exchange controls also in force, for various permissions under exchange control, along with their application for initial registration, FIIs shall also file with SEBI another application addressed to RBI for seeking various permissions under FERA, in a format that would be specified by RBI for this purpose. RBI's general permission would be obtained by SEBI before granting initial registration and RBI's FERA permission together by SEBI, under a single window approach.

5. For granting registration to the FII, SEBI shall take into account the track record of the FII, its professional competence, financial soundness, experience and such other criteria that may be considered by SEBI to be relevant. Besides, FII seeking initial registration with SEBI shall be required to hold a registration from the Securities Commission, or the regulatory organisation for the stock market in the country of domicile/incorporation of the FII.

6. SEBI's initial registration would be valid for five years. RBI's general permission under FERA to the FII will also hold good for five years. Both will be renewable for similar five year periods later on.

7. RBI's general permission under FERA would enable the registered FII to buy, sell and realize capital gains on investments made through initial corpus remitted to India, subscribe/renounce rights offerings of shares, invest on all recognised stock exchanges through a designated bank branch, and to appoint a domestic Custodian for custody of investments held.

8. This General Permission from RBI shall also enable the FII to:
a. Open foreign currency denominated accounts in a designated bank. (There can even be more than one account in the same bank branch each designated in different foreign currencies, if it is so required by FII for its operational purposes);
b. Open a special non-resident rupee account to which could be credited all receipts from the capital inflows, sale proceeds of shares, dividends and interests;
c. Transfer sums from the foreign currency accounts to the rupee account and vice-versa, at the market rate of exchange;
d. Make investments in the securities in India out of the balances in the rupee account;
e. Transfer repatriable (after tax) proceeds from the rupee account to the foreign currency account(s);
f. repatriate the capital, capital gains, dividends, incomes received by way of interest, etc. and any compensation received towards sale/renouncement of rights offerings of shares subject to the designated branch of a bank/the custodian being authorised to deduct with holding tax on capital gains and arranging to pay such tax and remitting the net proceeds at market rates of exchange;
g. Register FII’s holdings without any further clearance under FERA.

9. There would be no restriction on the volume of investment minimum or maximum for the purpose of entry of FIIs, in the primary/secondary market. Also, there would be no lock-in-period prescribed for the purposes of such investments made by FIIs. It is expected that the differential in the rates of taxation of the long term capital gains and short term capital gains would automatically induce the FIIs to retain their investments as long term investments.

10. Portfolio investments in primary or secondary markets will be subject to a ceiling of 30% of issued share capital for the total holdings of all registered FIIs, in any one company. The ceiling would apply to all holdings taking into account the conversions out of the fully and partly convertible debentures issued by the company. The holding of a single FII in any company would also be subject to a ceiling of 10% of total issued capital. For this purpose, the holdings of an FII group will be counted as holdings of a single FII.
11. The maximum holdings of 24% for all non-resident portfolio investments, including those of the registered FIIs, will also include NRI corporate and non-corporate investments, but will not include the following:
   a. Foreign investments under financial collaborations (direct foreign investments), which are permitted up to 51% in all priority areas.
   b. Investments by FIIs through the following alternative routes:
      i. offshore single/regional funds;
      ii. Global Depository Receipts;
      iii. Euro convertibles

12. Disinvestment will be allowed only through stock exchange in India, including the OTC Exchange. In exceptional cases, SEBI may permit sales other than through stock exchanges, provided the sale price is not significantly different from the stock market quotations, where available.

13. All secondary market operations would be only through the recognised intermediaries on the Indian Stock Exchange, including OTC Exchange of India. A registered FII would be expected not to engage in any short selling in securities and to take delivery of purchased and give delivery of sold securities.

14. A registered FII can appoint as Custodian an agency approved by SEBI to act as custodian of Securities and for confirmation of transactions in Securities, settlement of purchase and sale, and for information reporting. Such custodian shall establish separate accounts for detailing on a daily basis the investment capital utilisation and securities held by each FII for which it is acting as custodian. The custodian will report to the RBI and SEBI semi-annually as part of its disclosure and reporting guidelines.

15. The RBI shall make available to the designated bank branches a list of companies where no investment will be allowed on the basis of the upper prescribed ceiling of 30% having been reached under the portfolio investment scheme.

16. Reserve Bank of India may at any time request by an order a registered FII to submit information regarding the records of utilisation of the inward remittances of investment capital and the statement of securities transactions. Reserve Bank of India and/or SEBI may also at any time conduct a direct inspection of the records and accounting books of a registered FII.

17. FIIs investing under this scheme will benefit from a concessional tax regime of a flat rate tax of 20% on dividend and interest income and a tax rate of 10% on long term (one year or more) capital gains.
2.3.2 Investment by FIIs in Debt Securities

Following the announcement made by the Finance Minister to ease the restrictions on investment by FIIs in debt securities, the SEBI has approved the necessary changes to the SEBI (Foreign Institutional Investors) Regulations, 1995. The main features of the changes are as follows:

i. Any FII or sub-account already registered with SEBI or to be registered would continue to be governed by the ceiling of 30% on debt instruments.

ii. In addition, any registered FII willing to make 100% investments in debt securities will be permitted to do so, subject to specific approval from SEBI as a separate category of FIIs or sub-accounts as 100% debt funds. In such cases, the restriction of 30% debt will not be applicable.

iii. FII investment in debt through the 100% debt route will be subject to an overall debt cap of US$ 1.0-1.5 billion for investment by all FIIs mentioned in ii) above.

iv. SEBI will impose individual ceiling on individual funds or sub-accounts. This ceiling will be based on the track record of the FII and its experience in managing debt funds in emerging markets and other objective criteria. Individual debt funds would be informed of the respective ceiling at the time of the registration/approval.

v. Investments by FIIs through the 100% debt route would be permitted only in debt securities of companies which are listed or to be listed.

vi. Investment by FIIs in debt securities through the 100% route would be permitted without any restriction on maturity of the debt securities invested in.

vii. Investment by FIIs in debt securities through the 100% route would be without any limit on investment in the debt securities of any particular issues.

The SEBI Board had earlier approved changes to the FII regulations permitting investment by individual FIIs or sub-accounts of FIIs in up to 10% of the equity capital of investee companies, permitting investment in unlisted securities and including endowment funds in the eligible categories of FIIs. These changes have already come into effect on October 9, 1996 with their notification in the Official Gazette.
2.3.3 RBI Guidelines for FII Investment in Dated Government Securities

As a sequel to the Government's decision to permit Foreign Institutional Investors (FIIs) to invest in dated Government Securities, the Reserve Bank of India has announced the following guidelines for FIIs authorised to invest in dated Government Securities.

1. For the purpose of FII investment, dated government Securities would include dated securities of both Government of India and State Governments of all maturities, but would not include Treasury Bills.
2. Investment in dated government Securities by FIIs may be made either in the primary market at the auction/flotation or in the secondary market.
3. Investment by FIIs in dated Government Securities should be undertaken only through designated banks, i.e. any bank in India which has been authorised by the Reserve Bank to act as a banker to Foreign Institutional Investors.
4. Investment by FIIs will be allowed only in the form of Subsidiary General Ledger (SGL) Account through a bank having both SGL Account No. II (Constituents' Account) and current Account with the Reserve Bank of India.
5. The secondary market transactions by FIIs will be permitted through recognised Indian Stock Exchanges or over the counter with SGL Account holders and will be governed by the Delivery Versus Payment system of the Reserve Bank of India.

2.4 Foreign Investment Implementation Authority (FIIA)

Government has set up the Foreign Investment Implementation Authority (FIIA) in the Ministry of Commerce & Industry. The FIIA will facilitate quick translation of Foreign Director Investment (FDI) approvals into implementations, provide a pro-active one stop after care service to foreign investors by helping them obtain necessary approvals, sort out operational problems and meet with various Government Agencies to find solutions to problems and maximizing opportunities through a partnership approach.

Role of FIIA

The FIIA can take steps to:

- Understand and address concerns of investors;
- Understand and address concerns of approving authorities;
- Initiate multi agency consultations; and
- Refer matters not resolved at the FIIA level to high levels on a quarterly basis, including cases of projects slippage on account of implementation bottlenecks.

**Functions of FIIA**

The functions of the FIIA are as under:

- Expediting various approvals/permissions;
- Fostering partnership between investors and government agencies concerned;
- Resolve difference in perceptions;
- Enhance overall credibility;
- Review policy framework; and
- Liaise with the Ministry of External Affairs for keeping India's diplomatic missions abroad informed about translation of FDI approvals into actual investment and implementation.

The modalities of functioning of FIIA shall be as under:

i. The FIIA shall set up a Fast Track Committee (FTC) to review and monitor mega projects. It will nominate members of the FTC from representatives of various Ministries/agencies/State Government at the working level. The representative of the AM concerned shall act as the project coordinator and shall head the FTC. The FTC shall prescribe the time frame within which various approvals/permissions are to be given on a project to project basis. FTC shall also flag issues that need to be resolved by FIIA. Based on the inputs provided by FTC, the FIIA will give its recommendations on each project on the basis of which Administrative Ministries/State Government shall take action under their own laws and regulations.

ii. The FIIA will initiate inter Ministerial consultations and make appropriate recommendations to the competent authority, i.e. Ministry/Department concerned at the Central Government level and the State Government, as the case may be, on issues requiring policy intervention.
iii. The FIIA will act as a single point interface between the investor and Government agencies including Administrative Ministries/State Governments/Pollution Control Board/DGFT/Regulatory Authorities/Tax Authorities/Company Law Board, etc.

iv. The FIIA shall meet once every month to review cases involving investment of Rs. 100 crore or more, consider references received from the FTC, and monitor the functioning of various FTCs. It would also entertain any complaint regarding implementation bottlenecks from FDI approval holders regardless of the quantum of investment.

v. The FIIA shall also make recommendations from time to time on any issue relating to the speedy implementation of FDI projects and also to provide transparency in government functioning with respect to FDI projects.

The Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy & Promotion shall function as the Secretariat of the FIIA.

Approval holders are requested to send their suggestions and problems, if any to any of the following officers in SIA or at FIIA’s e-mail address at fiia@ub.nic.in:

a. Joint Secretary, SIA
b. Director (FIPB)
c. Director (FIIA)
d. Director (100% EOU & NRI Investment)
e. Director (IP&ID Cell)
f. Joint Director (IL & TC)

The issues raised are taken up with the concerned Department/authorities and are discussed in the meeting of FIIA.

FOREIGN INVESTMENT PROMOTION COUNCIL (FIPC)

Apart from making the policy framework investor-friendly and transparent, promotional measures are also taken to attract Foreign Direct Investment into the country. The Government has constituted a Foreign Investment Promotion Council (FIPC) in the Ministry of Industry. This comprises professionals from Industry and Commerce. It has been set up to have a more target oriented approach toward Foreign Direct Investment.
promotion. The basic function of the Council is to identify specific sectors/projects within the country that require Foreign Direct Investment and target specific regions/countries of the world for its mobilisation.

SECRETARIAT FOR INDUSTRIAL ASSISTANCE (SIA)

SIA has been set up by the Government of India in the Department of Industrial Policy and Promotion in the Ministry of Commerce & 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 organisations and State Governments) and in monitoring implementation of projects. It also notifies all Government Policy relating to investment and technology, and collects and publishes monthly production data for 213 select industry groups.

SIA's Promotional Activities

As an investor friendly agency, it provides information and assistance to Indian and foreign companies in setting up industry and making investments. It guides prospective entrepreneurs and disseminates information and data on a regular basis through its two monthly newsletters the "SIA Newsletter" and the "SIA Statistics" as also through its Website address, i.e. http://indmin.nic.in/ . It also assists potential investors in finding joint venture partners and provides complete information on relevant policies and procedures, including those, which are specific to sectors and the State Governments.

Entrepreneurial Assistance Unit (EAU) of the SIA

The Entrepreneurial Assistance Unit functioning under the Secretariat for Industrial Assistance, Department of Industrial Policy and Promotion provides assistance to entrepreneurs on various subjects concerning investment decisions. The unit receives all papers/applications related to industrial approvals and immediately issues a computerised acknowledgement which also has an identity/reference number. All correspondence with the SIA should quote this number. In case of papers filed by post, the acknowledgement will be sent by post. The Unit extends this facility to all papers/applications relating to IEMs, Industrial Licences, Foreign Investment, Foreign Technology Agreements, 100 per cent EOUs, EHTP, STP Schemes, etc.
The Unit also attends to enquiries from entrepreneurs relating to a wide range of subjects concerning investment decisions. It furnishes clarifications and arranges meetings with nodal officers in concerned Ministries/Organisations. The Unit also provides information regarding the current status of applications filled for various industrial approvals.

**Investment Promotion and Infrastructure Development (IP & ID) Cell**

In order to give further impetus to facilitation and monitoring of investment, as well as for better coordination of infrastructural requirements for industry, a new cell called the "Investment Promotion and Infrastructure Development Cell" has been created. The functions of the Cell include:

1. Dissemination of information about investment climate in India;
2. Investment facilitation;
3. Developing and distributing multimedia presentation material and other publications;
4. Organising Symposia, Seminars, etc. on investment promotion;
5. Liaison with State Governments regarding investment promotion;
6. Documentation of single window systems followed by various States;
7. Match-making service for investment promotion;
8. Coordination of progress of infrastructure sectors approved for investment/technology transfer, power, telecom, ports, roads, etc.;
9. Facilitating Industrial Model Town Projects, and Industrial Parks, etc.;
10. Promotion of Private Investment including Foreign Investment in the infrastructure sector;
11. Compilation of sectoral policies, strategies and guidelines of infrastructure sectors, both in India and abroad; and
12. Facilitating preparation of a perspective plan on infrastructure requirements for industry.

**Project Monitoring Wing**

Project Monitoring Wing, created within the IP&ID Cell in June 1998, has now been functioning under Foreign Investment Implementation Authority Section with effect from 27.7.2001. The functions of the Project Monitoring Wing are as follows:
(i) Coordination with Central and State level Ministries/Departments concerned and related agencies for tracking and monitoring approved projects, and compilation and analyses such information;

(ii) Direct contact, wherever necessary, with entrepreneurs and updation of the information on projects, and provision of necessary assistance.

**NODAL OFFICERS**

The Department of Industrial Policy and Promotion has identified officers at the Deputy Secretary/Director level as Nodal officers for facilitation of all matters relating to the industrial projects pertaining to a State. For large projects involving sizeable amount of FDI, officers have been identified in the Department of Industrial Policy and Promotion and other departments concerned (e.g. the Ministry to which the investment proposal pertains) and the State Government to act as contact officers so that these projects can be implemented within the time schedule. The officers of the Project Monitoring Wing are in touch with the contact officers.

**FOCUS WINDOWS**

The Department of Industrial Policy and Promotion also has opened Country Focus Windows for countries with sizeable investment interest in India. At present, the Focus Window cover countries such as USA, Germany, France, Switzerland, UK, Australia, Japan and Korea. For each focus window a senior officer in the Department provides facilitation and assistance.

**INTERNATIONAL CENTRE FOR ALTERNATIVE DISPUTE RESOLUTION**

International Centre for Alternative Dispute Resolution (ICADR) has been established as an autonomous organization under the aegis of Ministry of Law, Justice and Company Affairs to promote settlement of domestic and international disputes by different modes of alternate dispute resolution. ICADR has its headquarters in New Delhi and has regional office in Lucknow and Hyderabad. More information on ICADR can be obtained from the website: [http://www.icadr.org/](http://www.icadr.org/)
2.5 FDI Policy

Foreign Direct Investment (FDI) flows are usually preferred over other forms of external finance because they are non-debt creating, non-volatile and their returns depend on the performance of the projects financed by the investors. FDI also facilitates international trade and transfer of knowledge, skills and technology. In a world of increased competition and rapid technological change, their complimentary and catalytic role can be very valuable.

FDI enters in Indian economy in form of a significant involvement in equity stake and management control of foreign enterprises. Or investment involving a long-term relationship and reflecting a lasting interest in, and control by, a resident entity in one economy (foreign direct investor or parent enterprise) of an enterprise resident in a different economy (FDI enterprise or affiliate enterprise or foreign affiliate) It is a form of investment that benefits both the investing country as well as the host country. It can provide the foreign country with new markets and marketing channels along with lower production facilities, access to new technology, skill and financing. On the other hand the host country can benefit with sources of new technologies, capital processes organizational technologies and can overall be a great help to the overall economic development. It has brought upon sudden growth and transform in the worldwide investment pattern.

2.5.1 Types of FDI

Broadly speaking, FDI can be categorized under 5 major heading:

1. Greenfield investment - (a new operation)
2. Brownfield investment (expansions or re-investment in existing foreign affiliates or sites)
3. Mergers & Acquisitions (M&As)
4. Privatization and equity investment
5. New forms of investment (joint ventures, strategic alliances, licensing and other partnership agreements)
Foreign Direct Investment through all above categories in India is permitted as under in the following forms of investments:

- Through financial collaborations.
- Through joint ventures and technical collaborations.
- Through capital markets via Euro issues.
- Through private placements or preferential allotments.

Foreign capital through Private foreign investment can either be direct foreign investment or indirect foreign investment. Through FDI, foreign investor launches new branch or set off subsidiary company in recipient country and brings new technology, machinery, highly competent managerial and organizing skills, superior marketing strategies etc. The FDI has to go through legal formalities which comprise of

(a) Investment as approved by SIA (Secretariat for industrial approvals) and FIPB (Foreign investment promotion board),
(b) Investment as approved by reserve bank of India, and
(c) Investment by non resident Indians (NRIs); and

Foreign indirect investment or foreign portfolio investment linked to Indian economy through purchasing shares or debentures of recipient Countries' Company by foreign investor. This can be by way of

(a) GDRs (Global Depository Receipts),
(b) Investment by FIIs (Foreign Institutional Investors), and
(c) Offshore funds and others.
2.5.2 Government Policies and procedures

Automatic Route

- FDI up to 100% is allowed under the automatic route in all activities/sectors except the following which will require approval of the Government:
  a. Activities/items that require an Industrial License;
  b. Proposals in which the foreign collaborator has a previous/existing venture/tie up in India in the same or allied field
  c. All proposals relating to acquisition of shares in an existing Indian company by a foreign/NRI investor.
  d. All proposals falling outside notified sectoral policy/caps or under sectors in which FDI is not permitted.

An ongoing review of the FDI policy is carried out so as to initiate more liberalization. Change in sectoral policy/sectoral equity cap is notified to public at large from time to time through Press Notes and other modes of communications. This is done by the Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy & Promotion (DIPP). Policy announcement by SIA are subsequently notified by RBI under FEMA.

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

Areas/sectors/activities till now not open to FDI/NRI investment shall continue to be so unless otherwise decided and notified by Government. An investor can make an application for prior Government approval even when the proposed activity is under the automatic route.
**FIPB Route**

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

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

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

Application for proposals requiring prior Government's approval should be submitted to FIPB in FC-IL form. Plain paper applications carrying all relevant details are also accepted. No fee is payable.

All the proposals submitted to FIPB seeking FDI approval should include the following information:

- Whether the applicant has had or has any previous/existing financial/technical collaboration or trade mark agreement in India in the same or allied field for which approval has been sought;
- If an applicant has any approved proposal earlier, details thereof and the justification for proposing the new venture/technical collaboration (including trademarks) has to be submitted.
- Applications can also be submitted with Indian Missions abroad who will forward them to the Department of Economic Affairs (DEA) for further processing.
- Foreign investment proposals received in the DEA are placed before the Foreign Investment Promotion Board (FIPB) within 15 days of receipt.

The decision of the Government in all cases is usually conveyed by the DEA within 30 days of submission of the FDI proposal.
2.5.3 Liberalization of FDI

Beside 100 percent relaxation of FDI in real estate, the government policies on FDI also offer opportunities for foreign investors to invest in different sectors. This includes 100 percent in power trading, processing, development of new airports, laying of natural gas pipelines, petroleum infrastructure and warehousing of coffee and rubber. Limit for telecoms services firms have been raised from 49 per cent to 74 per cent.

Another cap to the retailing industry in India is allowing 51% FDI in single brand outlet. The government is now set to initiate a second wave of reforms in the segment by liberalizing investment norms further. And this has also brought about a conspicuous interest by towards investments in the Indian hospitality sector.

2.5.4 Sector Specific Foreign Direct Investment in India

**Hotel & Tourism: FDI in Hotel & Tourism sector in India**

100% FDI is permissible in the sector on the automatic route.

The term hotels include restaurants, beach resorts, and other tourist complexes providing accommodation and/or catering and food facilities to tourists. Tourism related industry include travel agencies, tour operating agencies and tourist transport operating agencies, units providing facilities for cultural, adventure and wild life experience to tourists, surface, air and water transport facilities to tourists, leisure, entertainment, amusement, sports, and health units for tourists and Convention/Seminar units and organizations.

For foreign technology agreements, automatic approval is granted if

i. up to 3% of the capital cost of the project is proposed to be paid for technical and consultancy services including fees for architects, design, supervision, etc.
ii. up to 3% of net turnover is payable for franchising and marketing/publicity support fee, and up to 10% of gross operating profit is payable for management fee, including incentive fee.

**Private Sector Banking:**

**Non-Banking Financial Companies (NBFC)**

49% FDI is allowed from all sources on the automatic route subject to guidelines issued from RBI from time to time.

a. **FDI/NRI/OCB investments allowed in the following 19 NBFC activities shall be as per levels indicated below:**

   i. Merchant banking
   ii. Underwriting
   iii. Portfolio Management Services
   iv. Investment Advisory Services
   v. Financial Consultancy
   vi. Stock Broking
   vii. Asset Management
   viii. Venture Capital
   ix. Custodial Services
   x. Factoring
   xi. Credit Reference Agencies
   xii. Credit rating Agencies
   xiii. Leasing & Finance
   xiv. Housing Finance
   xv. Foreign Exchange Brokering
   xvi. Credit card business
   xvii. Money changing Business
   xviii. Micro Credit
   xix. Rural Credit

b. **Minimum Capitalization Norms for fund based NBFCs:**

   i) For FDI up to 51% - US$ 0.5 million to be brought upfront
ii) For FDI above 51% and up to 75% - US $ 5 million to be brought upfront

iii) For FDI above 75% and up to 100% - US $ 50 million out of which US $ 7.5 million to be brought upfront and the balance in 24 months

c. **Minimum capitalization norms for non-fund based activities:**

Minimum capitalization norm of US $ 0.5 million is applicable in respect of all permitted non-fund based NBFCs with foreign investment.

d. Foreign investors can set up 100% operating subsidiaries without the condition to disinvest a minimum of 25% of its equity to Indian entities, subject to bringing in US$ 50 million as at b) (iii) above (without any restriction on number of operating subsidiaries without bringing in additional capital)

e. Joint Venture operating NBFC’s that have 75% or less than 75% foreign investment will also be allowed to set up subsidiaries for undertaking other NBFC activities, subject to the subsidiaries also complying with the applicable minimum capital inflow i.e. (b)(i) and (b)(ii) above.

f. FDI in the NBFC sector is put on automatic route subject to compliance with guidelines of the Reserve Bank of India. RBI would issue appropriate guidelines in this regard.

**Insurance Sector: FDI in Insurance sector in India**

FDI up to 26% in the Insurance sector is allowed on the automatic route subject to obtaining license from Insurance Regulatory & Development Authority (IRDA)

**Telecommunication: FDI in Telecommunication sector**

i. In basic, cellular, value added services and global mobile personal communications by satellite, FDI is limited to 49% subject to licensing and security requirements and adherence by the companies (who are investing and the companies in which investment is being made) to the license conditions for foreign equity cap and lock- in period for transfer and addition of equity and other license provisions.
ii. ISPs with gateways, radio-paging and end-to-end bandwidth, FDI is permitted up to 74% with FDI, beyond 49% requiring Government approval. These services would be subject to licensing and security requirements.

iii. No equity cap is applicable to manufacturing activities.

iv. FDI up to 100% is allowed for the following activities in the telecom sector:
   a. ISPs not providing gateways (both for satellite and submarine cables);
   b. Infrastructure Providers providing dark fiber (IP Category 1);
   c. Electronic Mail; and
   d. Voice Mail

   The above would be subject to the following conditions:

   e. FDI up to 100% is allowed subject to the condition that such companies would divest 26% of their equity in favor of Indian public in 5 years, if these companies are listed in other parts of the world.
   f. The above services would be subject to licensing and security requirements, wherever required.

Proposals for FDI beyond 49% shall be considered by FIPB on case to case basis.

Trading: FDI in Trading Companies in India

Trading is permitted under automatic route with FDI up to 51% provided it is primarily export activities, and the undertaking is an export house/trading house/super trading house/star trading house. However, under the FIPB route:

i. 100% FDI is permitted in case of trading companies for the following activities:
   - exports;
   - bulk imports with ex-port/ex-bonded warehouse sales;
   - cash and carry wholesale trading;
   - other import of goods or services provided at least 75% is for procurement and sale of goods and services among the companies of the same group and not for third party use or onward transfer/distribution/sales.

ii. The following kinds of trading are also permitted, subject to provisions of EXIM Policy:
a. Companies for providing after sales services (that is not trading per se)
b. Domestic trading of products of JVs is permitted at the wholesale level for such trading companies who wish to market manufactured products on behalf of their joint ventures in which they have equity participation in India.
c. Trading of hi-tech items/items requiring specialized after sales service
d. Trading of items for social sector
e. Trading of hi-tech, medical and diagnostic items.
f. Trading of items sourced from the small scale sector under which, based on technology provided and laid down quality specifications, a company can market that item under its brand name.
g. Domestic sourcing of products for exports.
h. Test marketing of such items for which a company has approval for manufacture provided such test marketing facility will be for a period of two years, and investment in setting up manufacturing facilities commences simultaneously with test marketing.

FDI up to 100% permitted for e-commerce activities subject to the condition that such companies would divest 26% of their equity in favor of the Indian public in five years, if these companies are listed in other parts of the world. Such companies would engage only in business to business (B2B) e-commerce and not in retail trading.

**Power: FDI in Power Sector in India**

Up to 100% FDI allowed in respect of projects relating to electricity generation, transmission and distribution, other than atomic reactor power plants. There is no limit on the project cost and quantum of foreign direct investment.

**Drugs & Pharmaceuticals**

FDI up to 100% is permitted on the automatic route for manufacture of drugs and pharmaceutical, provided the activity does not attract compulsory licensing or involve use of recombinant DNA technology, and specific cell / tissue targeted formulations.

FDI proposals for the manufacture of licensable drugs and pharmaceuticals and bulk drugs produced by recombinant DNA technology, and specific cell / tissue targeted formulations will require prior Government approval.
Roads, Highways, Ports and Harbors

FDI up to 100% under automatic route is permitted in projects for construction and maintenance of roads, highways, vehicular bridges, toll roads, vehicular tunnels, ports and harbors.

Pollution Control and Management

FDI up to 100% in both manufacture of pollution control equipment and consultancy for integration of pollution control systems is permitted on the automatic route.

Call Centers in India / Call Centers in India

FDI up to 100% is allowed subject to certain conditions.

Business Process Outsourcing BPO in India

FDI up to 100% is allowed subject to certain conditions.

Special Facilities and Rules for NRI's and OCB's

NRI's and OCB's are allowed the following special facilities:

1. Direct investment in industry, trade, infrastructure etc.
2. Up to 100% equity with full repatriation facility for capital and dividends in the following sectors:
   i. 34 High Priority Industry Groups
   ii. Export Trading Companies
   iii. Hotels and Tourism-related Projects
   iv. Hospitals, Diagnostic Centers
   v. Shipping
   vi. Deep Sea Fishing
   vii. Oil Exploration
   viii. Power
   ix. Housing and Real Estate Development
   x. Highways, Bridges and Ports
   xi. Sick Industrial Units
   xii. Industries Requiring Compulsory Licensing
   xiii. Industries Reserved for Small Scale Sector
3. Up to 40% Equity with full repatriation: New Issues of Existing Companies raising Capital through Public Issue up to 40% of the new Capital Issue.

4. On non-repatriation basis: Up to 100% Equity in any Proprietary or Partnership engaged in Industrial, Commercial or Trading Activity.

5. Portfolio Investment on repatriation basis: Up to 1% of the Paid up Value of the equity Capital or Convertible Debentures of the Company by each NRI. Investment in Government Securities, Units of UTI, National Plan/Saving Certificates.

6. On Non-Repatriation Basis: Acquisition of shares of an Indian Company, through a General Body Resolution, up to 24% of the Paid Up Value of the Company.

7. Other Facilities: Income Tax is at a Flat Rate of 20% on Income arising from Shares or Debentures of an Indian Company.

Certain terms and conditions do apply.

**Foreign Direct Investment in Small Scale Industries (SSI's) in India**

Recently, India has allowed Foreign Direct Investment up to 100% in many manufacturing industries which were designated as Small Scale Industries.

India further ended in February 2008 the monopoly of small-scale units on 79 items, leaving just 35 on the reserved list that once had as many as 873 items.

While industrial policy reforms began with the new industrial policy statement of 1991, India remained wary of intruding on the politically sensitive issue of reservation for small-scale industry till the end of the 1990s.

Thus, while at the turn of the millennium the number of items reserved for SSI units had come down from its peak of 873 in 1984, well over 800 items remained on the list.

Since 2002, the scenario has changed dramatically. In these last seven years, around 790 items - including things like farm equipment, toothpaste, ice cream, footwear, detergents and even garments - have been knocked off the list.

Thus, for the first time in over 40 years, there are today as few as 35 items reserved for SSI units. When the policy of reservation was first introduced in 1967, there were just 47 items reserved for small-scale manufacturers.
However, what was till then an administrative decision was given legal backing by an amendment enacted in 1984 to the Industries (Development and Regulation) Act, 1951. That year also saw the number of items reserved reaching a peak of 873.

Reservation means that units producing the reserved items cannot go beyond a stipulated cap on investment in plant and machinery. Moreover, FDI was allowed on a limited basis in SSI's.

In the old days, therefore, it was standard practice for mass consumption items covered by the reserved list to be farmed out by large marketing companies to dozens of small units, thereby negating economies of scale. What it also meant was that some companies resorted to manufacturing completely new class of products. So, if ice cream was reserved for small scale units, a large player could always produce, say, 'frozen desserts'. Apart from the steady trickle of de-reservation over the last decade, one of the measures taken to get over this problem without confronting the political problems involved was to allow foreign investment even in reserved items with the caveat that such units would have to fulfill an export obligation.

For players who were already manufacturing items that were suddenly reserved in 1967, the government came up with what was carry-on-business license which capped their capacity, and fixed the location of the plant and the goods produced.

The latest de-reservation means that pastries, hard boiled sugar candy and tooth powder can be manufactured by large units too. Similarly, buckets, paper bags, paper cups, envelopes, letter pads, paper napkins might not be manufactured only in small units but also in specialized factories.

The same for sesame and rapeseed oil, which are not solvent extracted, a host of chemicals and dyes paints be it distempers.

Electrical goods, which include geysers, hot air blowers and toasters, too are out of the reserved list, as are ballpoint and fountain pens.

The remaining 35 items that would be produced by the SSI sector are food and allied items, wood, wood products, paper, paper products, plastic products, organic chemicals, drugs, drug intermediates, other chemicals, chemical products, glass, ceramics, mechanical engineering and electrical machines, appliances and apparatus.
In a nutshell, only 35 items remain reserved for the small scale industries sector. For foreign investors, it means that in those 35 reserved sectors foreign investment is allowed on a limited basis, except where certain conditions are met.

**India Further Opens up Key Sectors for Foreign Investment**

India has liberalized foreign investment regulations in key sectors, opening up commodity exchanges, credit information services and aircraft maintenance operations. The foreign investment limit in Public Sector Units (PSU) refineries has been raised from 26% to 49%. An additional sweetener is that the mandatory disinvestment clause within five years has been done away with.

FDI in Civil aviation up to 74% will now be allowed through the automatic route for non-scheduled and cargo airlines, as also for ground handling activities.

100% FDI in aircraft maintenance and repair operations has also been allowed. But the big one, allowing foreign airlines to pick up a stake in domestic carriers has been given a miss again.

India has decided to allow 26% FDI and 23% FII investments in commodity exchanges, subject to the proviso that no single entity will hold more than 5% of the stake.

Sectors like credit information companies, industrial parks and construction and development projects have also been opened up to more foreign investment.

Also keeping India's civilian nuclear ambitions in mind, India has also allowed 100% FDI in mining of titanium, a mineral which is abundant in India.

The government wants to send out a signal that it is not done with reforms yet. At the same time, critics say contentious issues like FDI and multi-brand retail are out of the policy radar because of political compulsions. (Jan 2008)
2.6 Revised FDI regulations (17 February 2009)

The government has issued detailed guidelines on a liberal and investor-friendly foreign investment policy, under which foreign direct investment (FDI) up to 100 per cent is permitted through the automatic route in most sectors/activities.

Accordingly, FDI up to 26 per cent, under the FIPB route, is allowed for defense production subject to licensing under `Industries (Development & Regulation) Act, 1951' and guidelines on FDI in production of arms and ammunition.

In the air transport services sector, the government said, no foreign airlines would be allowed to participate directly or indirectly in the equity of an air service undertaking.

FDI up to 49 per cent and investment by non-resident Indians (NRI) up to 100 per cent will be allowed on the automatic route in domestic scheduled passenger airline sector.

FDI up to 74 per cent and investment by non-resident Indians (NRI) up to 100 per cent will be allowed on the automatic route in non-scheduled airlines, chartered airlines, and cargo airlines.

FDI up to 74 per cent and investment by NRI up to 100 per cent will be allowed on the automatic route in ground handling services; and
FDI up to 100 per cent will be allowed on the automatic route in maintenance and repair organizations; flying training institutes; technical training institutions; and helicopter services/seaplane services.

In the telecommunications sector, including basic and cellular, unified access services, national/ international long distance, V-Sat, public mobile radio trunked services (PMRTS), global mobile personal communication services (GMPCS) and other value added telecom services, equity has been capped at 49 per cent through the automatic route via FDI, FII, NRI, FCCBs, ADRs, GDRs, convertible preference shares and at 74 per cent through the FIPB route subject to guidelines.

Subject to licensing and security requirements notified by the department of telecommunications, FDI will also be allowed up to 49 per cent through the automatic route and up to 74 per cent via the FIPB route in ISP with gateways, radio-paging and end-to-end bandwidth.

Subject to the condition that such companies shall divest 26 per cent of their equity in favour of Indian public in 5 years, if these companies are listed in other parts of the world and also subject to licensing and security requirements, where required, FDI of up to 49 per cent through the automatic route and up to 100 per cent via FIPB route will be allowed in ISP without gateway, infrastructure provider providing dark fiber, right of way, duct space, tower (Category I); electronic mail and voice mail.

Subject to sectoral requirements, FDI up to 100 per cent will be allowed in the manufacture of telecom equipments through the automatic route. Subject to the guidelines notified by the ministry of information and broadcasting, FDI up to 26 per cent will be allowed in the print media, including publishing of newspaper and periodicals dealing with news and current affairs; and up to 100 per cent in publishing of facsimile edition of foreign newspapers, scientific magazines/specialty journals/periodicals, according to the government press note.
The policy on FDI is reviewed on a continuing basis through inter-ministerial consultations, the release said. The UNCTAD’s World Investment Reports for 2007 and 2008 have rated India as the second most attractive investment destination, the release noted.

2.7 Conclusion

Government policy plays a critical role in the sphere of international capital flow in a liberalized open economy. When foreign investment is expected to contribute positively to the industrial economy of a country, government policies concerning the nature, extent and pattern of foreign investment emerge as an area of serious debate. Moreover, the nature and extent of government policy regarding foreign investment is a crucial determinant of effective performance of the economy. The major objective of the study undertaken is to evaluate the impact of foreign investment on corporate performance in India making the study of foreign investment inflow policy framework of Indian government imperative.

The year of 1991 was a remarkable year for India as the economic reforms were exercised extensively and as a result brought the world much closer to the country. The then government maintained a strong hold on the economic activities taking place and too a large extent protected the domestic players from the intense global competition. The FDI policy came with a lot of restriction for the foreign companies. Only a limited number of companies were authorized to have an equity share of more than 40 per cent which therefore made them apprehensive in bringing their finest technologies to India.

The SEBI Board had earlier approved changes to the FII regulations permitting investment by individual FIIs or sub-accounts of FIIs in up to 10% of the equity capital of investee companies, permitting investment in unlisted securities and including endowment funds in the eligible categories of FIIs. These changes have already come into effect on October 9, 1996 with their notification in the Official Gazette.