Appendix-I

Important Policy changes in the Regulatory Framework

Improvements in the regulatory framework and encouragement by the government have played an important role in the increase in Indian investment abroad. Initial liberalisation of Indian policy towards outward FDI were made in the early 1990s. However, significant policy changes since 2000 contributed to the recent rapid growth of Indian outward FDI flows. The important milestones in the evolution of the policy reforms are chronicled below.

While Indian government’s regulatory framework towards Indian direct investment in joint ventures (JVs) and wholly owned subsidiaries (WOSs) abroad evolved since 1978, important regulatory changes continued to cover the whole period after 1992 till the current times.

In the year 1974 an Inter-Ministerial Committee on Joint Ventures Abroad was set up within the Ministry of Commerce by the Government of India to scrutinize the proposals made by Indian companies for overseas investment for granting approval. The Inter-Ministerial Committee formulated detailed guidelines for approving Indian companies’ proposal for overseas investment. These guidelines were prepared with view to synchronize Indian participation in accordance with the host country regulations. The guidelines encouraged formation of joint ventures with the host economy enterprises and Indian enterprise equity participation should be made in terms of exporting indigenous plant and machinery and also technical know-how from the existing Indian joint ventures. Keeping in view the scarcity of foreign exchange, the cash remittances of capital to overseas joint ventures were discouraged but provision was made to allow it in exceptional cases.

In 1978 the precise guidelines for IJVs and WOSs abroad were formulated which remained in place until 1992. The 1978 O-FDI guidelines permit registered Indian companies under the Companies Act, 1956 to undertake
overseas direct investment. This policy, underlined in the south-south cooperation, requires that Indian equity participation will have to be in accordance with the rules and regulations of the host country. This condition is a direct result of India’s conviction of not allowing its O-FDI to participate in fellow developing countries in ways, which India as a host country would not accept for inward investments (Ranganathan 1988).

The policy also required O-FDI to be clearly in the form of export of indigenous plant, machinery and equipment required for the JVs/WOSs. The export of machinery against Indian investment etc should be of ‘Indian made’ and not second-hand or reconditioned one. The policy also constituted an Inter-Ministerial Committee (IMC) to permit Indian equity participation by way of capitalization of fees, royalties, and other entitlements after considering the merit of the O-FDI projects. Except the ‘hard and deserving’ O-FDI cases, cash remittances against Indian equity participation were discouraged given the fact that India itself was suffering from resource scarcity to meet its planned industrialization programme.

The Government of India had also established economic divisions in the Ministries of Industry and Commerce to facilitate JVs abroad by collecting and disseminating data on the opportunities for overseas ventures. In short, the basic essence of O-FDI policy before 1992 was inspired by the desire of using Indian direct investment abroad as tool of promoting Indian exports but without offering any scope for local capital to shift trans-border through cash remittances. (Pradhan, 2005).

The modified guidelines for Indian JVs and WOSs issued in October 1992 were to make O-FDI policy regime more transparent and suitable in the context of current global developments and Indian business realities. The 1992 guidelines define O-FDI as the investment by way of contribution to the equity share capital of foreign concern with a view to acquiring a long term interest in that concern or subscription to the Memorandum of Association of a foreign entity.
For the first time the guideline provided an automatic approval route for an Indian company to undertake JVs/WOSs apart from the existing normal route. For O-FDI proposals under the automatic route no prior approval from the regulatory authority is required for setting up a JV/WOS abroad. A direct investment abroad by an Indian business entity will qualify for automatic approval by Reserve Bank of India (R.B.I.), provided the value of Indian equity does not exceed $2 million, of which $500,000 could be in cash and the rest by the capitalization of Indian exports of plant, machinery, equipment and know-how. The O-FDI proposals under the normal route require the prior clearance of regulatory authority by making a specific application in ‘Form ODI’ to the RBI.

**Government of India, Ministry of Commerce Notification No. 4/1/93-EP (OI) dated 17th August, 1995.**

The O-FDI regime was further liberalized in August 1995 with investment ceiling under automatic approval route raised to Rs. 120 crores in Indian rupee investment in Nepal and Bhutan, $30 million in the case of other SAARC countries and Myanmar, and $15 million in all other cases. Further, it was required that the amount of investment under the automatic route, except investments in Nepal and Bhutan as well as investment made by Indian software firms, must not exceed 25% of annual average exports/foreign exchange earnings of the Indian party in the preceding three years. The Indian entity, besides cash remittances against overseas investment, can also contribute by capitalization of Indian made plant, machinery, equipment, goods, and services like know-how, consultancy, and managerial services.

All applications not falling under the automatic approval route will be referred to a Special Committee appointed by the RBI which has as members, representatives from different Ministries such as Commerce, Finance, and External Affairs and from the Department of Company Affairs and RBI.

The policy as opposed to 1978 guidelines clearly mentioned that O-FDI under the automatic as well as normal route may take the form of export of second-
hand or reconditioned indigenous machinery against Indian equity participation in the foreign concerns.

Reserve Bank of India, Exchange Control Department notification EC.CO.PCD.No.


The regulatory framework for Indian direct investment abroad has been further liberalized with the issue of modified notification in May 1999 by Ministry of Commerce and various other circulars issued by RBI, which are later consolidated in the Master Circular, issued in July 2002.

- Reserve Bank of India Notification No. FEMA.40/2001RB; 2 March 2001
  - The three years profitability condition requirement has been removed for Indian companies making overseas investments under the automatic route.
  - Overseas investments are allowed to be funded up to 100% by American Depository Receipt/General Depository Receipt proceeds; up from the previous ceiling of 50%.
  - Overseas investments are opened to registered partnership firms and companies that provide professional services. The minimum net worth of Rs. 150 million for Indian companies engaged in financial sector activities in India has been removed for investment abroad in financial sector

- Reserve Bank of India Notification No. FEMA.49/2002RB; 2 March 2001
  - An Indian party which has exhausted the limit of $100 million in a year may apply to the Reserve Bank of India for a block allocation of foreign exchange subject to such terms and conditions as may be necessary.
• Reserve Bank of India Notification No. FEMA.49/2002RB; 19 January 2002

- Indian companies in Special Economic Zones can freely make overseas investment up to any amount without the restriction of the $100 million ceiling under the automatic route, provided the funding is done out of the Exchange Earners Foreign Currency Account balances.


- The annual limit on overseas investment has been raised to $100 million (up from $50 million) and the limit for direct investments in South Asian Association for Regional Cooperation countries (excluding Pakistan) and Myanmar has been raised to $150 million (up from $75 million); for Rupee investments in Nepal and Bhutan the limit has been raised to Rs. 700 crores (up from Rs. 350 crores) under the automatic route.

• Reserve Bank of India Notification No. 83/RB 2003; 1 March 2003

- Indian companies can make overseas investments by market purchases of foreign exchange without prior approval of the Reserve Bank of India up to 100% of their net worth; up from the previous limit of 50%.
- An Indian company with a proven track record is allowed to invest up to 100% of its net worth within the overall limit of $100 million by way of market purchases for investment in a foreign entity engaged in any bona fide business activity starting fiscal year 2003-2004. The provision restricting overseas investments in the same activity as its core activity at home of the Indian company are removed. Listed Indian companies, residents and mutual funds are permitted to invest abroad in companies listed on a recognised stock exchange and in company which has the shareholding of at least 10% in an Indian company listed on a recognised stock exchange in India.
• **Changes brought about in fiscal year 2003-2004**

  o Indian firms are allowed to undertake agricultural activities, which was previously restricted, either directly or through an overseas branch.

  o Investments in joint venture or wholly-owned subsidiary abroad by way of share swap are permitted under the automatic route;

  o In January 2004, the Reserve Bank of India further relaxed the monetary ceiling on Indian companies’ investment abroad. With effect from fiscal year 2003-2004, Indian companies can invest up to 100% of their net worth without any separate monetary ceiling even if the investment exceeds the $100 million ceiling previously imposed. Furthermore, Indian companies can now invest or make acquisitions abroad in areas unrelated to their business at home.

  o In 2005, banks were permitted to lend money to Indian companies for acquisition of equity in overseas joint ventures, wholly owned subsidiaries or in other overseas companies as strategic investment.

  o In 2006, the automatic route of disinvestments was further liberalized. Indian companies are now permitted to disinvest without prior approval of the RBI in select categories. To encourage large and important exporters, proprietary/unregistered partnership firms have been allowed to set up a JV/WOS outside Indian with the prior approval of RBI.

  o In 2007, the ceiling of investment by Indian entities was revised from 100 per cent of the net worth to 200 per cent of the net worth of the investing company under the automatic route of overseas investment. The limit of 200 per cent of the net worth of the Indian party was enhanced to 300 per cent of the net worth in June 2007 under automatic route (200 per cent in case of revisited partnership firms). In September 2007, this was further enhanced to 400 per cent of the net worth of the Indian party.
The Liberalized Remittance Scheme (LRS) for Resident individuals was further liberalized by enhancing the existing limit of US$ 100.00 per financial year to US$ 200.00 per financial year (April-March) in September 2007.

The limit of portfolio investment by listed Indian companies in the equity of listed foreign companies was raised in September 2007 from 35 per cent to 50 per cent of the net worth of the investing company as on the date of its last audited balance sheet. Furthermore, the requirement of reciprocal 10 per cent shareholding in Indian companies has been dispensed with.

The aggregate ceiling for overseas investment by mutual funds, registered with SEBI, was enhanced from US$ 4 billion to US$ 5 billion in September 2007. This was further raised to US$ 7 billion in April 2008. The existing facility to allow a limited number of qualified Indian mutual funds to invest cumulatively up to US$ 1 billion in overseas Exchange Traded Funds, as may be permitted by terms and conditions and operational guidelines as issued by SEBI.

Registered Trusts and Societies engaged in manufacturing/educational sector have been allowed in June 2008 to make investment in the same sector(s) in a Joint Venture or Wholly Owned Subsidiary outside India, with the prior approval of the Reserve Bank.

Registered Trusts and Societies which have set up hospital(s) in India have been allowed in August 2008 to make investment in the same sector(s) in a JV/WOS outside India, with the prior approval of the Reserve Bank.

From April 2010, Indian companies have been allowed to participate in a consortium with other international operators to construct and maintain submarine cable systems on co-ownership basis under the automatic route.
o From May 2011 fifty percent of the amount of performance guarantees were allowed to be reckoned for the purpose of computing financial commitment to its JV/WOS overseas.

o From May 2011, Indian promoters of WOS abroad or having at least 51 Percent stake in an overseas JV, allowed to write-off capital or other receivables in respect of the JV/WOS.

o From June 2011, Indian parties allowed to disinvest without prior approval of the RBI, where the amount repatriated on disinvestment is less than the amount of the original investment with certain conditions.