



This will bring more FDI to India...

India is a very lucrative market to invest in. There is a lot of money just waiting to pour in, the government has now liberalised the FDI policy to some extent. Following are broadly the new changes

FDI opens floodgates , paves way for more R&D

The government has loosened up the agriculture sector. 100% FDI will now be permitted in the development and production of seeds and planting material, floriculture, horticulture, and cultivation of vegetables & mushrooms under controlled conditions. Besides, animal husbandry, pisciculture, aquaculture under controlled conditions, services related to agro and allied sectors have also been allowed 100% FDI. The tea sector, as well, will be a beneficiary of 100% FDI.

...The agriculture sector is set to benefit from the relaxation of norms since they now will be permitted in the development and production of seeds and planting material without the stipulation of having to do so under any "controlled conditions". We see the R&D space getting a huge leg up from the new policy...

Cash & carry' firms may be allowed to break free

The cap of 25% on sales to group companies likely to be removed

- The draft of the revised foreign direct investment (FDI) policy has proposed easier norms for cash & carry and wholesale trading companies with foreign partners. The present policy allows 100% FDI in cash & carry and wholesale trading under the automatic route, but subject to a key restriction — the company cannot sell products worth more than 25% of its turnover to group companies.
- The government now wants to delete this restriction, which has come under fire from both foreign retailers and their Indian partners for restricting growth.
- This will give relief to leading foreign cash & carry companies whose Indian partners run separate retail chains. The companies will be able to supply freely to retail stores owned by their partners.

HIGHLIGHTS

- **The agriculture sector is set to benefit from the relaxation of norms since they now will be permitted in the development and production of seeds and planting material without the stipulation of having to do so under any "controlled conditions".**
- **The cap of 25% on sales to group companies likely to be removed**
- **New FDI policy for private equity industry**
 - Companies have now been classified into only two categories - 'companies owned or controlled by foreign investors' and 'companies owned and controlled by Indian residents'
 - The Government has now decided to permit issue of equity ,in the following cases, subject to stipulated conditions:
 - import of capital goods/ machinery/ equipment (including second-hand machinery)
 - pre-operative/ pre-incorporation expenses (including payments of rent etc.)
 - Pricing of convertible instrument - greater flexibility introduced
 - The government has removed the restrictive condition of obtaining prior approval of Indian companies for making investments in the 'same field'. This will promote an atmosphere of competition and thus attract higher FDI and technology inflows.
 - An FII may invest in the capital of an Indian company either under the FDI Scheme/Policy or the Portfolio Investment Scheme.
- **Higher minimum capitalisation norm for each real estate project proposed The minimum capitalisation will be calculated by each project and not just by the total project cost**
- **FDI either through M&A or through strategic stakes is going to be a big theme in India and that will add to the market enthusiasm as the year goes through**
- **The new M&A draft regulations, will be fine tuned so that the "unintentional obstacles" are taken care of. The implementation of the M&A norms will take place as scheduled from June 1, 2011.**



New FDI policy spells relief for private equity industry

- The FDI guidelines have been comprehensively simplified and rationalised. Companies have now been classified into only two categories - 'companies owned or controlled by foreign investors' and 'companies owned and controlled by Indian residents'. The earlier categorization of 'investing companies', 'operating companies' and 'investing-cum-operating companies' has been done away with. This would have a bearing on companies with majority foreign equity as they would now be classified as foreign companies.
- The existing policy FDI provided for conversion of only ECB/lump-sum fee/Royalty into equity. The Government has now decided to permit issue of equity, with prior approval from FIPB, in the following cases, subject to stipulated conditions:

- *import of capital goods/ machinery/ equipment (including second-hand machinery)*
- *pre-operative/ pre-incorporation expenses (including payments of rent etc.)*

Some of the conditions stipulated are:

- § Import to be as per Export/ Import policy issued by GOI/ as defined by DGFT
- § Independent valuation of capital goods by third party entity, preferably by independent valuer from country of import
- § Application to clearly indicate beneficial ownership of importer company as well as overseas entity
- § Conversion to be done within 180 date from the date of shipment/retention of advance
- § Verification and certification of preoperational/ pre-incorporation expenses by statutory auditor
- § Payment of pre-incorporation expenses should be made directly by overseas entity to the company
- § Special resolution for conversion to be passed

- Pricing of convertible instrument - greater flexibility introduced

This has been done through amendment made in Clause 3.2.1 of the Circular which earlier provided that *"The pricing of the capital instruments should be decided/determined upfront at the time of issue of the instruments"*

Now it has been added that "price / conversion formula" be determined upfront so in effect instead of having to specify the price of convertible instruments upfront, companies will now also have the option of prescribing a conversion formula, subject to the condition that price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with the prevailing

valuation norms (viz. DCF method of valuation for the unlisted companies). This would help the recipient companies in obtaining a better valuation based upon their performance.

- The government has also removed the restrictive condition of obtaining prior approval of Indian companies for making investments in the 'same field'. This has been done through deletion of Clause 4.2.2 of the earlier Circular (No. 2 of 2010) which provided that FDI would be subject to the "Existing Venture/ tie-up conditions" as stated in sub-clauses of Clause 4.2.2 (basically stating that where a non-resident investor has an existing joint venture/ technology transfer/ trademark agreement, as on January 12, 2005, new proposals in the same field for investment/ technology transfer/ technology collaboration/trademark agreement would have to be under the Government approval route through FIPB/ Project Approval Board . A discussion paper had been released by DIPP last year on the need for review of this condition. Based on stakeholder comments received by the DIPP on its discussion paper, the Government while releasing the FDI Circular 1 of 2011 has in its press release stated that it has decided to abolish this condition.

It is expected that this measure will promote the competitiveness of India as an investment destination and be instrumental in attracting higher levels of FDI and technology inflows into the country

We believe this is a move in the right direction. While the new policy will definitely attract more FDI, it will also plug the loopholes for back door FDI entry

- An FII may invest in the capital of an Indian company either under the FDI Scheme/Policy or the Portfolio Investment Scheme. 10% individual limit and 24% aggregate limit for FII investment would still be applicable even when FIIs invest under the FDI scheme/policy. It has now been clarified that aggregate FII limit of 24% can be increased to sectoral cap/ statutory ceiling by Board of Directors resolution followed by special resolution in shareholders meeting. While this has always been clear under the FEMA provisions, the earlier FDI Circulars did not specifically mention this and now with this amendment the provisions relating to FII investments are aligned with the FEMA provisions.





FDI norms for real estate sector to get tougher

The foreign direct investment (FDI) norms for the sector, will not only make rules stricter but will also make exit norms stiffer for foreign firms investing in the sector.

- The new rules are based on the recommendations by the Reserve Bank of India (RBI) to prevent cases of money laundering. It proposes higher minimum capitalisation norm for each real estate project. Currently, a realty company is required to have a minimum capital of \$10 million, while a joint venture (JV) firm should have \$5 million.

This rule will put pressure on the companies to ensure timely execution of the project which will ensure that the money goes to construction and not anywhere else.

These rules are not going to pose any problem for companies that raise funds for completing projects. The problem, if any, will be for those who are diverting the fund for either debt repayment or to some other project which is not FDI-compliant.

- Also, now the minimum capitalisation will be calculated by each project and not just by the total project cost. The rule is aimed to ensure that the money pumped into the company is used in the project and should not be diverted for other purposes. Currently, the government has allowed 100 per cent FDI in realty projects via the automatic route with a three-year lock-in period on investments. The norms also specify the minimum area required for the project to be qualified for FDI. The new rules also lay out stricter exit norms for companies that invest in the projects. The lock-in period will remain unchanged but the refund of the money will not be possible before 50 per cent of the construction work is completed.
- As a result, in cases where the project is not at least 50 per cent complete, investors will not be able to exit the venture even if the lock-in period is at an end. This rule will put pressure on the companies to ensure timely execution of the project which will ensure that the money goes to construction and not anywhere else. Another rule proposed is stricter norms for foreign investors buying non-convertible debentures (NCDs).

M&A draft regulations to be fine tuned to iron out 'unintentional obstacles'

The new mergers and acquisition (M&A) draft regulations, which have created quite a flutter among corporates, will be fine tuned so that the "unintentional obstacles" are taken care of, the implementation of the M&A norms will take place as scheduled from June 1, 2011.

The main concern of the government is to convey to foreign investors that the competition regime in the country is investor-friendly and transparent. Issues like local nexus and high fees to be paid for filing under Form I would be managed by fine tuning the regulations.

FDI through M&A or strategic stakes is going to be big in India

One theme that we would want to mention here is inward M&A into India. US companies do sit on \$2 trillion of cash and if you are a believer of the India story over the long term, then some of this inward M&A has got to start happening because if you want to get exposure to India, the landscape is fraught with people or companies who have failed in terms of trying to start from scratch. So companies will come in and just acquire other companies or strategic stakes like BP did with Reliance. So you are going to see more and more of this. So FDI either through M&A or through strategic stakes is going to be a big theme in India and that will add to the market enthusiasm as the year goes through. So that's something to watch out for. Maybe this is just a prelude to other companies doing acquisitions in many other different sectors. So expect M&A into India to be huge this year.

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