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GOVERNMENT APPROVES MAJOR FDI POLICY REFORMS

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Introduction

The Union Cabinet on 28 August 2019 has issued a press release proposing some significant changes to the Foreign Direct Investment (FDI) policy of the Government of India, specifically relating to 4 (four) sectors as detailed below. Whilst the fine print of the revised policy is awaited, following are some of the key changes proposed:

Key changes proposed to the FDI policy

(a) Contract Manufacturing

Under the current FDI policy, FDI of upto 100% is permitted under the automatic route (that is, without the prior approval of any governmental authority) in the manufacturing sector and there is no specific provision for contract manufacturing. It is now proposed to be clarified that 100% FDI will be permitted under the automatic route specifically for contract manufacturing activities undertaken in India. This means that foreign investors can set up and operate entities engaged solely in the business of contract manufacturing. The liberalization has been announced with a view to giving a boost to the 'Make In India' initiative and will benefit high value sectors, such as, the pharmaceutical sector.

(b) Digital Media

Under the current FDI policy, FDI upto 26% is permitted under approval route for print media (that is, publishing of newspaper and periodicals dealing with news and current affairs) and of upto 49% under approval route in 'Up-linking of News and Current Affairs' TV channels. There is no express provision with respect to digital media in the current policy. Considering the growing number of internet users, it has now been decided to bring digital media at par with print media and allow FDI of up to 26% under approval route for 'uploading/streaming of news and current affairs' on digital media. It is interesting to note that the current FDI policy does not include any limit or restriction on investment in digital media, hence this proposal has in a way introduced a limit on the permissible FDI in this sector. One would need to see the fine print of the revised policy (specifically definition of digital media) to ascertain the impact and extent of this restriction.

(c) Single brand retail trading (SBRT)

Under the current FDI policy, FDI of upto 100% is permitted under the automatic route in the SBRT sector subject to a condition that 30% of the value of goods purchased have to be sourced from India, if the SBRT entity has FDI of more than 51%. For the first 5 (five) years, this local sourcing requirement can be met as an average of the total value of goods purchased during these 5 (five) years. The 5 (five) year period is to be calculated from 1st April of the year of commencement of business (i.e. the opening of the first SBRT store). After the expiry of this 5 (five) year period, the sourcing requirement has to be met on an annual basis.

Sourced goods could be exported: The current FDI policy does not provide any specific condition/ restriction with respect to end use of the sourced goods. However, with a view to giving a boost to exports, it has been clarified that the goods procured in India to meet the local sourcing requirement can be sold in India or may also be exported. Further, the current ceiling of considering exports for 5 (five) years only is intended to be removed.

E-commerce operations permissible prior to opening of physical stores: The FDI policy currently allows only entities having brick and mortar stores to undertake SBRT through e-commerce. With the digital age ushering in a new avenue of commerce and online shopping options, it is now proposed to allow online trade by entities engaging in SBRT prior to such entities opening a brick and mortar store, on the condition that it will open brick and mortar stores within 2 (two) years from the date of start of online retail. This will help entities engaging in SBRT to undertake online sales prior to having a physical presence in India.

Incremental sourcing for global operations done by unrelated third party on behalf of SBRT entity/group companies allowed:

Under the current FDI policy, incremental sourcing for global operations by an entity engaging in SBRT, either directly or through its group companies is counted towards the local sourcing requirement for the initial 5 (five) years. The Government, while recognizing prevalent market practices where such global sourcing may even be done by an unrelated third party at the behest of the entity engaging in SBRT or its group companies, has decided to include such purchases while ascertaining compliance with the local sourcing requirement, provided there is a legally tenable agreement authorizing the unrelated third party to make such purchases.

Entire sourcing from India for global operations to be counted for the purpose of local sourcing:

The current FDI policy provides that only that part of the global sourcing which is over and above the previous years' value will be counted towards the local sourcing requirement. It has now been decided that the entire sourcing from India for global operations (and not just for the incremental value) will be counted towards the local sourcing requirement. This move will eliminate the discrimination faced by companies with lower exports as against companies with consistently high exports.

(d) Coal Mining

Under the current FDI policy, FDI of up to 100% is permitted under the automatic route in coal and lignite mining for captive consumption by power projects, iron and steel and cement units and other eligible activities subject to applicable laws. Also, FDI of up to 100% under the automatic route is permitted for setting up coal processing plants like washeries subject to the condition that the company shall not do coal mining and shall not sell washed coal or sized coal from its coal processing plants in the open market and shall supply the washed or sized coal to those parties who are supplying raw coal to coal processing plants for washing or sizing.

With a view to attracting global mining companies to invest in India and tackle the issue of fuel shortage, it has now been decided to lift the ban on commercial coal mining activities and permit FDI of up to 100% under the automatic route for sale of coal, for coal mining activities including associated processing infrastructure, subject to applicable regulations. Associated processing infrastructure would include coal washery, crushing, coal handling and separate (magnetic and non-magnetic).

Conclusion

The proposed changes have been announced to give an impetus to the economy, increase foreign inflows into the country, promote 'Make in India' initiative, boost exports and make India an attractive destination for foreign players. Having said this, there are still certain ambiguities in the current FDI policy which have not been addressed by the Government. For example, for SBRT, there is no clarity on the meaning of the term "state of the art" and "cutting edge technology", or on whether SBRT entities can undertake retail trading of sub-brands. Further, so far as digital media is concerned, the limit proposed could be construed as a restriction, unless the fine print of the revised policy appropriately includes suitable clarifications in this regard.

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