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Analysing developments impacting business

LIBERALISATION OF FDI RULES | PRESS NOTE 4

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INTRODUCTION

On 28 August 2019, the government announced critical changes liberalising foreign direct investment (FDI) norms in: (a) single-brand retail trading (SBRT) (b) contract manufacturing (c) uploading / streaming of news and current affairs through digital media and (d) coal mining.

Subsequent to the announcement of government, on 18 September 2019, the Department for Promotion of Industry and Internal Trade (DPIIT), issued press note 4 of 2019 (PN 4 of 2019) in order to give effect to the government's directive to liberalise the foresaid sectors and by notifying appropriate amendments to the Consolidated Foreign Direct Investment Policy (dated 23 August 2017) (FDI Policy).

Details of the changes introduced

1. Single brand retail trading

Existing provision: As per the existing local sourcing norms, companies engaged in SBRT and having foreign investment in excess of 51% were required to source 30% of the value of goods purchased from India.

New provision: In terms of the new requirements of PN 4 of 2019, all procurement made from India by single brand retailers for that single brand is to be counted towards local sourcing irrespective of whether the goods procured are sold in India or exported. Further, the computation of 30% local sourcing which was earlier done on an incremental year-by-year analysis has now been altered to a five year period.

In addition, 'sourcing of goods from India for global operations' can be done directly by the SBRT entity or its group company or by a third party under a legally tenable agreement with them.

In addition, single brand retailers are now permitted to start online sales, doing away with the previous condition of setting up a mandatory brick-and-mortar store, subject to compliance with local sourcing norms. Retail trading through online sales can now be commenced even before operations through brick and mortar stores are initiated subject to the condition that the SBRT entity will be required to open brick and mortar stores within 2 years from the start of online trading.

2. Contract Manufacturing

Existing provision: Presently, 100% FDI is permitted under automatic route in manufacturing sector. However, the question of whether this included 'contract manufacturing' was ambiguous.

New provision: The new provisions clarify that foreign investment in 'manufacturing' sector including contract manufacturing is under automatic route. Manufacturing activities can now be either self-manufacturing by the investee entity or contract manufacturing in India through a legally tenable contract, whether on Principal to Principal or Principal to Agent basis.

3. Digital Media

Existing provision: While 49% FDI under approval route is permitted for Up-linking of 'News & Current affairs' TV channels, the FDI Policy made no mention of news aggregators.

New Provision: The government has now clarified that 26% FDI is allowed in *Uploading/ Streaming of News & Current Affairs through Digital Media* on similar lines of print media. The government has not defined "digital media" and accordingly it is still not clear as to whether digital news aggregators, which have direct relationships with online news publishers and stream' news and current affairs will be covered within the ambit of the term "digital media" or whether online intermediaries as well as applications that technically 'upload' and 'stream' news and current affairs only by providing links to other news websites will be covered under "digital media".

Further, the government may have considered a grace period within which, existing entities engaged in digital media could have to be restructured their shareholding in order to comply with the revised FDI norms. The 26 % FDI cap may require an exit / dilution of foreign shareholders.

4. Coal Mining

Existing provision: Earlier, 100% FDI was permitted under the coal mining sector under the automatic route only for coal and lignite mining for captive consumption by power plants, iron & steel and cement units and not for only associated activities.

New provision: Now, 100% FDI will be allowed for coal mining its sale, as well as associated processing infrastructure. Associated processing infrastructure includes coal washery, crushing, coal handling and separation, including both magnetic and non-magnetic.

Comment

It is expected that the liberalisation in the local sourcing norms will bring in more investment in the SBRT sector so as to serve both domestic and international markets.

The government has also brought contract manufacturing within the scope of manufacturing generally, subject to execution of a legal tenable contract. This move is expected to give a big boost to sectors such as pharmaceuticals and electronics which heavily rely on the contract manufacturing model.

These changes introduced by the DPIIT were expected after the Hon'ble Finance Minister's budget speech. Do note however, these are merely policy announcements and will have the force of law after amendments to the provisions of the Foreign

Exchange Management (Transfer and Issue of Securities to Persons Resident Outside India) Regulations, 2017.

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