Guess paper MAINS 2019

GUESS PAPER SERIES

SESSION - 21

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FDI REFORMS

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Foreign direct investment (FDI) is an investment made by a firm or individual in one country into business interests located in another country. Generally, FDI takes place when an investor establishes foreign business operations or acquires foreign business assets, including establishing ownership or controlling interest in a foreign company. **FDI are distinguished from portfolio investments in which an investor merely purchases equities of foreign-based companies.**

Investment climate in India has improved considerably since the opening up of the economy in 1991. This is largely attributed to ease in FDI norms across sectors of the economy. India, today is a part of **top 100 club on Ease of Doing Business (EoDB)** and globally ranks 1st in the greenfield FDI ranking. India received the record FDI of $ 60.1 bn in 2016-17.

Foreign Direct Investment (FDI) **stimulates economic growth**. Its importance increases especially when a country faces a **shortage of funds for economic growth**. Beyond a point, the government cannot take debt from external sources. Hence, FDI as a major source of **non-debt finance** becomes extremely important. In India, there is an **investor-friendly policy on FDI**. And FDI up to 100 percent in most sectors/economic activities is allowed through the automatic route in most sectors/activities.

Despite high flexibility and opening up of economy since 1991, **some strategic sectors have been restricted**:

- Lottery Business including Government/private lottery, online lotteries, etc.
- Gambling and Betting including casinos
- Chit Funds
- Nidhi Company
- Trading in Transferable Development Rights (TDR)
- Real Estate Business or Construction of farm houses (Real estate business shall not include development of town shops, construction of residential/ commercial premises, roads or bridges and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations, 2014)
- Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes
- Sectors not open to private sector investment- atomic energy, railway operations (other than permitted activities mentioned under the Consolidated FDI policy)

PROCEDURE FOR GOVERNMENT APPROVAL (wherever needed)

Filing of Application

Proposal for foreign investment, along with supporting documents to be filed online, on the **Foreign Investment Facilitation Portal**.

Internal Procedure for Approvals

- DPIIT will identify the concerned Ministry/ Department and thereafter, circulate the proposal within 2 days. In addition, once the proposal is received, the same would also be circulated online to the RBI within 2 days for comments from FEMA perspective.
- Proposed investments from Pakistan and Bangladesh would also require clearance from the Ministry of Home Affairs.
- DPIIT would be required to provide its comments within 4 weeks from receipt of an online application, & Ministry of Home Affairs (if applicable) to provide comments within 6 weeks.
- Pursuant to the above, additional information/ clarifications may be asked from the applicant which is to be provided within 1 week.
- Proposals involving FDI exceeding INR 50bn (approx. $ 775 mn) shall be placed before the Cabinet Committee of Economic Affairs.

Final Approval

Once the proposal is complete in all respects, the same gets approved within **8-10 weeks.**

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India emerged as the **top recipient of greenfield FDI Inflows from the Commonwealth**, as per a trade review released by The Commonwealth in 2018.

Some of the recent significant FDI announcements are as follows:

- In October 2018, **VMware**, a leading software innovating enterprise of US has announced investment of US$ 2 billion in India between by 2023.
- In August 2018, **Bharti Airtel** received approval of the Government of India for sale of 20 per cent stake in its DTH arm to an America based private equity firm, Warburg Pincus, for around $350 million.
- In June 2018, **Idea**'s appeal for 100 per cent FDI was approved by Department of Telecommunication (DoT) followed by its Indian merger with Vodafone making Vodafone Idea the largest telecom operator in India
- In May 2018, **Walmart** acquired a 77 per cent stake in **Flipkart** for a consideration of US$ 16 billion. .
- In February 2018, **Ikea** announced its plans to invest up to Rs 4,000 crore (US$ 612 million) in the state of Maharashtra to set up multi-format stores and experience centres.
- Kathmandu based conglomerate, **CG Group** is looking to invest Rs 1,000 crore (US$ 155.97 million) in India by 2020 in its food and beverage business.
- **International Finance Corporation (IFC), the investment arm of the World Bank Group**, is planning to invest about **US$ 6 billion** through 2022 in several sustainable and renewable energy programmes in India.

GOVERNMENT INITIATIVES

As of February 2019, the Government of India is working on a road map to achieve its **goal of US$ 100 billion worth of FDI inflows.**

In February 2019, the Government of India released the **Draft National e-Commerce Policy** which **encourages FDI in the marketplace model of e-commerce**. Further, it states that the FDI policy for e-commerce sector has been developed to ensure a level playing field for all participants.

KEY HIGHLIGHTS OF THE POLICY

1. Bar online retailers from **selling products through vendors in which they have an equity interest**.
2. Also bars them from **entering into exclusive deals with brands for selling products only on their platforms**.
3. **All online retailers will be required to maintain a level playing field** for all the vendors selling their products on the platform, and it shall not affect the sale prices of goods in any manner.
4. **Disallows e-commerce players to control the inventory of the vendors**. Any such ownership over the inventory will convert it into inventory based model from marketplace based model, which is not entitled to FDI.
5. Under the new rules, **the e-commerce retailer shall be deemed to own the inventory of a vendor if over 25 per cent of the purchases of such a vendor are through it**.
6. **Restricts marketplaces from influencing prices** in a bid to curb deep discounting. With this, special offers like cashback, extended warranties, faster deliveries to some brands will be prohibited, with the view to provide a level playing field.

In September 2018, the Government of India released the **National Digital Communications Policy, 2018** which envisages increasing FDI inflows in the telecommunications sector to **US$ 100 billion by 2022.**

In January 2018, Government of India allowed **foreign airlines to invest in Air India up to 49 per cent with government approval**. The investment cannot exceed 49 per cent directly or indirectly.

No government approval will be required for FDI up to an extent of 100 per cent in Real Estate Broking Services.

In September 2017, the Government of India asked the states to focus on strengthening **single window clearance system for fast-tracking approval processes**, in order to increase Japanese investments in India.

The Ministry of Commerce and Industry, Government of India has eased the approval mechanism for foreign direct investment (FDI) proposals by **doing away with the approval of Department of Revenue** and mandating clearance of all proposals requiring **approval within 10 weeks after the receipt of application.**

The Government of India is in talks with stakeholders to further ease foreign direct investment (FDI) in defence under the automatic route to 51 per cent from the current 49 per cent, in order to give a boost to the Make in India initiative and to generate employment.

In January 2018, Government of India allowed **100 per cent FDI in single brand retail** through automatic route.

RECENT REFORMS

I. 100% FDI under automatic route in coal mining and associated infrastructure

- It will attract international players to create an efficient and competitive coal market.

II. 100% FDI in contract manufacturing under automatic route

- Manufacturing through contract contributes equally to the objective of Make in India.
- FDI now being permitted under automatic route in contract manufacturing will be a big boost to Manufacturing sector in India.

CONTRACT MANUFACTURING

The business model in which a firm hires a contract manufacturer to produce components or final products based on the hiring firm's design. **Companies outsource their production to other companies.** Contract manufacturing offers a number of benefits:

- **Cost Savings:** Companies save on their capital costs and labour costs because they do not have to pay for a facility and the equipment needed for production. Some companies may look to contract manufacture in low-cost countries, such as India, to benefit from the low cost of labour.
- **Advanced Skills:** Companies can take advantage of skills that they may not possess, but the contract manufacturer does.
- **Focus:** Companies can focus on their core competencies better if they can hand off base production to an outside company.
- **Economies of Scale:** Contract Manufacturers have multiple customers that they produce, it may lead to reduced costs in acquiring raw materials by benefiting from economies of scale.

III. Relaxing FDI rules for single brand retail; expands definition of 30% domestic sourcing

- It will lead to greater flexibility and ease of operations for SBRT entities, besides creating a level playing field for companies with higher exports in a base year.

IV. Online retailing under single-brand retail; relaxing rule of mandatory brick-and-mortar store (it should be opened within 2 years from the date of start of online retail).

- Permitting online sales prior to opening of brick and mortar stores brings policy in sync with current market practices.
- Online sales will also lead to creation of jobs in logistics, digital payments, customer care, training and product skilling.

SINGLE BRAND RETAIL

Single-brand retail refers to a business that sells goods to individual customers and not other businesses and such goods are all sold under the same brand. Nike, for example, sets up stores in India in which the foreign parent of Nike (Nike Inc.) invests. Such stores can only sell Nike products under the 'single brand' route.

As opposed to that, **multi-brand retail** are businesses that sell goods to individual customers and such goods can carry several different brands. Walmart is an example of multi-brand retail, which stocks and sells goods from various brands.

V. 26% FDI under government route for uploading/ streaming of News & Current Affairs through Digital Media, on the lines of print media, has been permitted.

CONCLUSION

Annual FDI inflows in the country are expected to rise to US$ 75 billion over the next five years, as per a report by UBS. The Government of India is aiming to achieve US$ 100 billion worth of FDI inflows in the next two years.

In India, FDI policy provisions have been progressively liberalized across various sectors in recent years to make India an attractive investment destination. Some of the sectors include Defence, Construction Development, Trading, Pharmaceuticals, Power Exchanges, Insurance, Pension, Other Financial Services, Asset reconstruction Companies, Broadcasting and Civil Aviation.

Due to these measures, a total FDI into India from 2014-15 to 2018-19 has been $ 286 billion. Despite the dim global picture **(UNCTAD's World Investment Report 2019)**, India continues to remain a preferred and attractive destination for global FDI flows. India seeks to use this potential to attract far more foreign investment which can be achieved inter-alia by further liberalizing and simplifying the FDI policy regime.