Client Alert

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Significant Liberalization of Foreign Investment Rules in India

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On June 20, 2016, the Indian government, in an effort to open up the Indian economy and bring in much-needed foreign capital, announced a radical liberalization of the foreign direct investment (FDI) rules by liberalizing restrictions on foreign investments into various sectors (please refer to the Appendix for a summary).

The key sectors which have been the subjects of this liberalization and where an increased level of FDI is anticipated are set out below.

DEFENCE

Under the previous rules, FDI up to 49% is permitted under the automatic route[1], and any FDI beyond 49% was required to take the approval route and was only permitted if it was likely to result in access to modern and "state of the art" technology.

Under the new FDI rules, FDI beyond 49% - is now permitted under the approval route without the need to demonstrate that the technology is "state of the art" (although the technology still must be "modern").

More joint ventures between Indian and foreign companies are expected as a result of this change. It has been reported that some of India's largest corporates such as Reliance Group, Tata Group, Mahindra Group and Bharat Forge have already signed MoUs with foreign firms to set up defence manufacturing facilities.

CIVIL AVIATION

The new FDI rules allow foreign investors other than airlines to hold up to 100% of the equity of an Indian airline. However, the previous FDI cap of 49% remains in place for foreign airlines.

While foreign airlines which currently own minority stakes in Indian airlines, such as Jet Airways, AirAsia India and Vistara will not be permitted to increase those stakes beyond 49%, the Indian Government is attempting to encourage non-airline foreign investors such as sovereign wealth and private equity funds to bolster FDI into this sector, although it remains to be seen whether there is an appetite for this sector amongst this group of investors.

Foreign investors are also now permitted to hold 100% of the equity in greenfield airport projects and 74% in brownfield airport projects under the automatic route. This is intended to help fund the modernization of airports which have been estimated to require about USD 30 – 40 billion of capital over the next 10 to 15 years.

[1] There are two routes by which FDI enters India: (i) Automatic route: FDI is permitted without prior approval by the government or the Reserve Bank of India; and (ii) Approval route: Prior approval by government is needed and Foreign Investment Promotion Board is the responsible agency overseeing this route.

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PHARMACEUTICALS

74% FDI is now permitted under the automatic route for brownfield projects. The change will lead to more deals in the pharma sector, which already posted double digit growth in 2015, as it will allow the current Indian shareholders to sell their stakes to foreigners without having to go through the approval process, which previously added delays to transaction timelines as well as transaction uncertainty. According to the president of the Indian Drug Manufacturers' Association, FDI inflows, totaling approximately USD 3 billion, are expected in the pharma sector over the next few years.

FOOD

100% FDI under the approval route is now permitted for retail trading of food products manufactured or produced in India. This also includes trading by means of e-commerce.

This liberalization will allow global retail chains such as Walmart, Tesco, Carrefour etc. to set up physical and online food retail stores in India. This change is also likely to benefit Indian online grocers such as Bigbasket.

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Appendix

A summary of the main changes introduced is set out in the table below.

No	Sector/Activity	Revised Provisions
1.	**Defence**	• Automatic route up to 49% • Approval route up to 100% with access to modern technology • This also covers the manufacturing of small arms and ammunition
2.	**Broadcasting:** 1) Teleports 2) Direct to Home 3) Cable Networks 4) Mobile TV 5) Headen-in-the Sky Broadcasting Service	• Automatic route up to 100% • However, infusion of fresh foreign investment beyond 49% in a company not seeking license/permission from sectoral Ministry, resulting in change in the ownership pattern or transfer of stake by existing investor to new foreign investor, will require government approval
3.	**Civil aviation:** Airports	• Automatic route up to 100% for both greenfield and existing projects
4.	**Civil aviation:** 1) Scheduled air transport service/Domestic scheduled passenger Airline 2) Regional air transport service	• Automatic route up to 49% (100% for NRIs) • Approval route up to 100% • However, foreign airlines are only permitted to invest up to 49%
5.	**Civil aviation:** Non-scheduled air transport service	• Automatic route up to 100% • However, foreign airlines are only permitted to invest up to 49%
6.	**Pharmaceuticals**	• Automatic route up to 100% for greenfield projects • Automatic route up to 74% and Approval route up to 100% for Brownfield projects
7.	**Private security agencies**	• Automatic route up to 49% • Approval route up to 74%
8.	**Agriculture:** 1) Floriculture, horticulture and cultivation 2) Development and production of seeds and planting materials 3) Animal husbandry 4) Agro services	• Automatic route up to 100%

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No	Sector/Activity	Revised Provisions
9.	**Food manufacturing**	• Approval route up to 100% for trading (including e-commerce) of food products manufactured and/or produced in India
10.	**Single brand retail trading**	• Automatic route up to 49% • Approval route up to 100% • Foreign investment beyond 51% requires sourcing of 30% of the value of goods purchased to be done from India, preferably from Medium, Small & Micro Enterprises, village and cottage industries, artisans and craftsmen, in all sectors. This procurement requirement would have to be met, in the first instance, as an average of five years' total value of the goods purchased, beginning 1st April of the year of the commencement of the business i.e. opening of the first store. Thereafter, it would have to be met on an annual basis. This sourcing requirement will not be applicable up to three years from commencement of business i.e. opening of the first store for entities undertaking single brand retail trading of products having 'state-of-art' and 'cutting-edge' technology and where local sourcing is not possible
11.	**Establishment of branch office, liaison office and project office**	• If the principal business of the applicant is (i) Defence, (ii) Telecom, (iii) Private Security, or (iv) Information and Broadcasting, the approval of the Reserve Bank of India is not required where Foreign Investment Promotion Board approval or license/permission by the relevant Ministry/Regulator has already been granted

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