Journal of Civil & Legal Sciences

Research Article Open Access

INDIA: Foreign Direct Investment Policy - Analyzing Changes in Regulatory Trends During A Global Pandemic

Meenakshi Acharya*

Founder Partner at RMA Legal, Advocates & Solicitors, Mumbai, Maharashtra, India

Abstract

The impacts of the Covid-19 pandemic have led to a significant contraction in the Indian Economy. Further, the political implications of Chinese aggression have led to changes being made in the Indian FDI policy in order to offset its economic expansion into the country. In order to boost economic growth and development, and offset current international political trends, the government notified several changes to the FDI policy.

Keywords: Chinese aggression, Government of India, FDI policy, Investment Policy and resulting in the beneficial ownership

Introduction

The Government of India, vide the Press Note No. 3 (2020 Series) dated April 17, 2020 aimed to curb "opportunistic takeovers/acquisitions of Indian companies due to the current COVID-19 pandemic" ostensibly by Chinese investors. Pursuant to this amendment, all investments by entities incorporated in a "country which shares land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country" will require prior regulatory approval; in the event of any transfer of ownership of any existing or future FDI in an entity in India, directly or indirectly, resulting in the beneficial ownership falling within the restriction/purview of such change in beneficial ownership will also require prior regulatory approval".

I. Changes to Indian FDI and allied policies in light of the COVID-19 pandemic.

The following countries fall within the ambit of the same: Bhutan, China, Nepal, Myanmar, Afghanistan, Pakistan and Bangladesh. While FDI from Pakistan and Bangladesh were already subject to regulatory approval under the FDI policy, this move allows for the inclusion of China into this ambit. This move comes just after the Indian Government's clarification that required the Securities and Exchange Board of India to increase its scrutiny of investments in the Indian stock markets from China and Hong Kong . Experts have propounded that the revised policy is a temporary measure to protect India's economy from pandemic stress and that Chinese foreign investment is not prohibited, but rather that a screening process has begun to assess the impact of investment, as countries around the world are trying to deal with the burden of the pandemic while preserving their economic stability. Other Nations such as Australia have already put in place plans and concrete measures to stop such opportunistic takeovers/acquisitions. India's decision can influence liquidity in Indian companies, especially start-ups, in the short term. At least 18 out of 23 Indian start-ups are backed by leading Chinese investors, such as Alibaba, Tencent and Ant Financial, including Paytm, Snapdeal, Ola, Swiggy, Zomato, and Big Basket . However, while investments may be affected for the time being, it is unlikely that China will stop investing in India or India will block Chinese firms' investment proposals. This revised policy is a step to ensure that during the COVID-19 outbreak, the Indian economy is secure.

A. **Changes made to FDI rules in the Media Sector.**

Changes have been made in the media sector to enable 26 per cent of FDI to upload and stream news and current affairs via digital media under government approvals. Two heads, broadcasting and print media, were broadly grouped under the media sector in the erstwhile. Investment limits were set at 49% under the government approval route for the up-linking of news and current affairs television channels and at 26% for the publication of newspapers and periodicals dealing with the same issues. The previous FDI policy was silent so far as digital media was concerned. This leads to the argument that the online nature of the sector allowed for 100% FDI under the automatic route . Operating on this assumption, several creator-led digital news platforms raised foreign capital in excess of the limit prescribed, and now concerned that they already have FDI in excess of the 26% cap . An ambiguity this has caused is whether the FDI cap would be applicable to aggregator led digital news platforms that simply consolidate news articles and do not create original content. Further, this move, in light of the recent COVID-19 pandemic has been criticized as been restrictive rather than a method of liberalization. The FDI limit of 26 percent can be considered a setback to India's evolving digital media industry and inconsistent with the Start-up India and Digital India campaigns, as many players in the digital media space are start-ups. As the previous FDI regime in digital media was viewed as allowing 100 percent under the automatic route, this is seen to be likely to adversely affect FDI . The Clarification brings an end to the ambiguity surrounding the ambit of Press Note 4 ("PN4") and confirms the categories of entities operating in the digital media space which will have to adhere to the FDI restrictions. The scope of the applicability of Press Note 4, which has now been amply clarified by the Government, is quite broad and extends to cover all news aggregators as well as news agencies which supply information to digital media firms and companies which upload news and current affairs on their websites, apps and other online platforms. Additionally, all these digital media companies which have now been brought under the purview of Press Note 4 will need to restructure their shareholding in compliance with Press Note 4 and seek the approval of the government in respect of their existing FDI, within a period of 1 (One) year from October 16 2020. Further, while the Government has allowed this grace period of 1 (one) year, it however needs to be seen how quickly the Government would process/favorably respond to the approval applications from digital media companies with existing FDI. Where the approval is rejected, concerns/challenges could arise in relation to the return of the

***Corresponding author:** Meenakshi Acharya, Founder Partner at RMA Legal, Advocates & Solicitors, Mumbai, Maharashtra, India, Tel: 919987933318, E-mail: meenakshi@rmalegal.net

Received April 18, 2021; **Accepted** May 15, 2021; **Published** May 18, 2021

Citation: Acharya M (2021) INDIA: Foreign Direct Investment Policy - Analyzing Changes in Regulatory Trends During A Global Pandemic. J Civil Legal Sci 10: 267.

capital by the investee company to the foreign investor(s), particularly in cases where the investee company or the Indian promoters are under financial distress (on account of COVID-19) or where there are no potential third party buyers for a secondary sale and consequently expose the investee company or the Indian promoters to a potential litigation.

B. Changes made to FDI rules in the broadcasting sector.

Certain conditions for the broadcasting sector have been detailed in the new FDI Policy, especially in light of Covid-19 such as the mandatory requirement of key executives to be resident Indian citizens, security clearance of key executives, meeting of national security conditions, monitoring, inspection and submission of information for such purposes, and meeting requirements in relation to infrastructure, network, and software. The Department for Promotion of Industry and Internal Trade ("DPIIT") clarification dated October 16, 2020, in relation to the scope of applicability of DPIIT's Press Note 4 of 2019, for entities engaged in 'uploading or streaming of news and current affairs through digital media' has also been included in the FDI Policy. However, the Non-debt Instrument ("NDI") Rules have not been amended to make such conditions applicable to the broadcasting sector.

C. Changes made to FDI rules in e-commerce.

The buying and selling of goods and services on technology platforms has grown exponentially during Covid-19. E-commerce platforms, under the FDI Policy 2020 are of two types, the inventory model and the marketplace model. In the inventory model, goods and services are owned by an e-commerce entity and sold directly to consumers. In the marketplace model, an e-commerce entity provides a platform on an electronic network to facilitate transactions between buyers and sellers. The new policy imposes restrictions on e-commerce entities using the marketplace model. E-commerce entities are obliged to not directly or indirectly influence the sale price of goods or services and to maintain a level playing field. While the FDI policy permits an e-commerce entity to provide support services to sellers such as warehousing, logistics, order fulfilment, call centre services, payment collection and advertisements these should be provided at arm's length and in a fair and non-discriminatory manner. The new guidelines around direct FDI and support infrastructure is likely to restrict the ability of these technology giants to monopolize crucial market spaces which became much more easy during the course of the pandemic since the ability to insulate from market shocks is a strategic advantage that cannot have competitive value in an already fragile system. The FDI related provisions, the rules and sector specific regulations together make it clear that technology platforms are not to discriminate among vendors using them. They are obliged to maintain a level playing field and to be neutral under existing legal literature but did not have a cogent direction from the Government. Under the new rules however platforms shall be transparent, make disclosure of differential treatment, deal on an arm's length basis and not make exclusive arrangements. From the domestic regulatory trend, it is evident that we are moving towards non-discriminatory open access to technology platforms. This will benefit not only vendors, but also consumers as well.

II. FDI Rules for Foreign Investment beyond India.

In the wake of the economic and financial crisis caused by the COVID-19 pandemic, India has revised its foreign direct investment ("FDI") policy through Press Note 3 of 2020 ("Press Note") imposing stricter norms on foreign investments in Indian companies from an investor based out of bordering countries. The primary objective of the revised FDI policy is to curb any opportunistic takeovers or acquisitions of Indian companies during the COVID-19 pandemic. Separately, one of the key driving factors behind the introduction of FDI limit by the Government in some sectors was to monitor the risk of latent foreign influence which seemed to stem from increased foreign participation (especially from China) in the digital media space in India. The additional restrictions requiring the key management personnel of the investee entities to be Indian citizens along with the requirement for the security clearance of any foreign personnel who are sought to be associated with the digital media companies seem to be an extension of the foregoing intent/security concerns and are in line with the similar restrictions that are applicable to the Indian companies operating (with FDI) in the news broadcasting carriage services, print media and the radio broadcasting sectors. The COVID-19 pandemic is accelerating the trend towards stricter control and screening of foreign investments as many States have recently announced amendments to their Foreign Direct Investment ("FDI") rules to protect strategic domestic industries.

A. **International position on FDI regulations in light of Covid-19.**

In response to the COVID-19 pandemic, FDI controls are rapidly intensifying around the world. On March 25, 2020, the European Commission ("EC") issued guidelines noting an "increased risk of attempts to acquire healthcare capacities or related industries such as research establishments" and calling upon EU Member States that already have an FDI screening mechanism in place to make full use of the tools available. The EC also called on those EU Member States that do not have an FDI screening mechanism in place to adopt similar procedures. Based on similar concerns about certain foreign trade practices, the EC also published a White Paper on June 17, 2020, launching a consultation on how to deal with the "Distortive effects caused by Foreign Subsidies" . One of the proposed regulatory instruments is a compulsory notification mechanism that would allow for an extant review of planned acquisitions involving foreign subsidies. Already prior to pandemic, the EU had adopted Regulation 2019/452 , which creates an EU-level mechanism for co-ordinated screening of FDIs through information exchange and gives the EC the possibility to issue non-binding opinions on specific transactions. This regulation will apply from 11thOctober 2020.A number of EU Member States have also announced stricter FDI control rules since the COVID-19 outbreak. France has lowered the approval threshold for acquisition by foreign investors from 25 percent to 10 percent, for listed "sensitive" companies until the end of 2020 (applicable only to investors outside the EU and the EEA) and has extended the scope of its FDI screening to cover biotechnologies. In the same vein, Italy has expanded the notification duty for FDIs to new strategic sectors and temporarily applies notification requirements also to foreign buyers from within the EU. Similar measures have been adopted by other EU Member States, including Spain and Germany.

Such measures are not limited to the EU and its Member States. Other States have also taken significant steps to protect their domestic companies from foreign takeover. Furthermore, on June 5, 2020, Australia also announced what it describes as the "most significant reforms to the Foreign Acquisitions and Takeovers Act 1975 since its introduction". Among other things, the proposed reforms enable the Treasurer to impose conditions or block any foreign investment on national security grounds, regardless of the value of the investment. On the same grounds, the Treasurer is given the power to impose or vary existing conditions for foreign investments, or, as a last resort, require the divestment of any realized investment, even if that investment was previously approved.

On June 21, 2020, the UK Government also announced changes to the Enterprise Act 2002, which will allow the Government to intervene in mergers and takeovers on public health grounds. Although these changes will apply to both foreign and domestic takeovers, the UK Government emphasized that they are aimed at allowing it to "scrutinize certain foreign takeovers to ensure they do not threaten the UK's ability to combat a public health emergency". These changes, which also extend the UK Government's existing powers to intervene in mergers on National security grounds, are intended to mitigate risks in the short term ahead of a planned new National Security and Investment Bill. First, the proposed review mechanism would apply to investors from any country, with no minimum target turnover or market share thresholds to be met.

- Acquisitions of assets and intellectual property as well as of minority shareholdings (except where the shareholding is less than 15% and does not give rise to “material influence over the policy of the entity”) would be caught by the text of the proposed Regulation.

- The revenue and share of supply thresholds under the Enterprise Act 2002 will cease to apply and the UK Secretary of State will be able to intervene in any transaction that potentially threatens national security, irrespective of the value of the transaction foreseen. According to UK Government’s statement of policy intent, the Secretary of State will consider on a case-by-case basis the risk to National Security based on whether the transaction could enable.

A new Bill by the UK Government also introduces a five-year retrospective “call-in” power allowing for post-completion review of non-notified transactions, applicable to any transaction falling within the scope of the new mechanism which is completed from the date of publication of the bill. In concrete terms, the Secretary of State would be able to call in a trigger event that has happen up to six months after the Secretary of State became aware of it, so long as it is done within five years of the trigger event occurring [1-10].

B. Indo-Chinese FDI regulations in light of Covid-19.

In a significant change to the Foreign Direct Investment Policy 2017 ("FDI Policy"), the Department for Promotion of Industry and Internal Trade has issued Press Note No. 3 (2020 Series) dated April 17, 2020 ("Press Note 3"), wherein it has imposed certain restrictions for receiving FDI from neighbouring countries. According to the Press Note 3, any entity of a country which shares its land borders with India. Or where the beneficial owner of any investment in India is based in such country or is citizen of such a country will now require prior approval from the Government for its direct investment in India. Additionally, any transfer of ownership (whether existing or future) of an entity in India resulting in the beneficial ownership being situated in a Specified Country will also require prior Government approval . Prior to the issuance of Press Note 3, citizens of/entities incorporated in Pakistan and Bangladesh required Government approval for investing in India. The most notable addition to the change under Press Note 3 was China. The recent increase of stake by People's Bank of China in HDFC from 0.8% to 1.01% through open market purchases appears to be the trigger for the above reaction by the Government. The Indian Government is keen to curb any opportunistic takeovers/acquisitions of Indian companies who may be suffering from poor valuation due to the current COVID-19 pandemic.

Overseas funds can flow in India from China both through FDI and the Foreign Portfolio Investors ("FPIs") routes with substantial inflows into capital markets. The FPI can invest less than ten per cent (10%) of the total paid-up equity capital of a company on a fully diluted basis or less than ten per cent (10%) of the paid-up value of each series of debentures or preference shares or share warrants issued by an Indian company. As per reports , the Securities and Exchange Board of India ("SEBI") is currently scrutinizing the FPIs coming from China and Hong Kong considering that there are 16 Chinese FPIs registered in India. It is possible that SEBI may issue certain notifications in tandem with Press Note 3 to augment its control over the FPI coming from the Specified Countries. While many FPIs use jurisdictions such as Singapore and Mauritius to pool in resources before investing in India, it appears that the ultimate beneficial ownership details of these FPIs would be carefully assessed going forward. Amongst the Specified Countries, China has the highest foreign direct investment with approximately INR 14,900 Crores invested during the period beginning April 2000 to December 2019 . It is evident that the focus of Press Note 3 is aimed at controlling and mapping investments from Chinese entities in India and minimizing the opportunistic acquisition of Indian businesses from China during the current COVID-19 pandemic [11-21].

Conclusion

India’s regulatory framework for FDI is in the form of a series of notifications, circulars and press notes, with FEMA and its allied regulations forming the bedrock upon which the same are grounded. The national FDI policy is reflective of larger economic objectives for the country in the form of meeting growth trajectories and development objectives. A decision to allow for FDI into a sector is rooted in two primary objectives- the need to allow foreign investment to allow for influx of funds into a sector and the simultaneous restrictions put in place to allow for Make in India, Invest India and other national investment oriented goals. The efficacy of the implementation of these provisions is largely determined by compliance with the same, and hence, strict adherence to procedures such as time limitations for granting approvals for FDI will go a long way in ensuring a stable climate for investment into India. Further, recent changes to sector specific regulators such as e-commerce, broadcasting and media have allowed for the FDI policy to be in line with targeted development agendas. Deregulation in terms of some sectors have augmented influx of funds made by the Government vide the 2020 National Budget. As the COVID-19 pandemic has disproportionately affected the aviation sector, changes in FDI requirements as per the same will allow for India to meet its 100% divestment agenda from Air India Limited. Changes to the Media sector have allowed for Government regulation into digital media, which was previously unregulated in terms of FDI. This is in tandem with the larger protectionist economy debate taking place in nations worldwide. The increase in compliance requirements made in 2020 has been done to protect the nation from opportunistic international takeovers and Chinese economic expansionism.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

References

1. Lee J (2020) Note on COVID-19 and the Police Powers Doctrine: Assessing the Allowable Scope of Regulatory Measures during a Pandemic. Contemp Asia Arb J 13:229.
2. Latola V. European FDI Regulatory Framework and China.
3. https://dipp.gov.in/sites/default/files/pn3
4. https://dipp.gov.in/sites/default/files/FDI-PolicyCircular

5. https://www.businesstoday.in/current/economy-politics/fdi-digital-media-26-foreign-direct-investment-limit-fund-flows-hurt-business
6. https://dipp.gov.in/sites/default/files/FDI-Policy
7. Kumar Mn. Fdis Are Crucial For India To Become A 5 Trillion Dollar Economy-A Special Reference To Service Sector.
8. https://dipp.gov.in/sites/default/files/FDI
9. https://dipp.gov.in/whats-new/consolidated-fdi-policy-circular
10. Udapudi SV, Ghosh B (2012) The information technology act of India: A Critique. ZENITH Int J Bus Econ Manag Res 2(5):182-194.
11. Khare A. Doubts about new IT rules are groundless.
12. https://research.hktdc.com/en/article/NTM0MDMyOTc2
13. https://eur-lex.europa.eu/eli/reg/2019/452/oj
14. http://trade.ec.europa.eu/doclib/docs/2019/february/tradoc
15. https://treasury.gov.au/consultation/c2020-99761
16. https://www.gov.uk/government/publications/enterprise-act-2020-guidance-on-changes-to-the-public-interest-considerations-in-merger-cases
17. https://publications.parliament.uk/pa/bills/lbill
18. https://bills.parliament.uk/bills/2801
19. Misra P, Tripathi P (2019) The legal and policy questions in Foreign Direct Investment: An assessment using Indian case 1. In Transformative Law and Public Policy 28:92-110. Routledge India.
20. https://www.business-standard.com/article/finance/people-s-bank-of-china-sells-stake-in-hdfc-in-june-quarter-following-furore`
21. https://dipp.gov.in/sites/default/files/pn3