CHAPTER-III

INDIA'S POLICY TOWARDS FDI: AN EXAMINATION

3.1 INTRODUCTION :

After having surveyed the existing literature on FDI and its impact on economic growth, trade intensity of the Indian economy and productivity of local industries, in this chapter FDI policy as evolved over the years in India will be examined. Most of the countries now expect a lot from FDI, as it is a non debt financial resource. In addition to providing financial support it is a source of technical knowhow, international trade and employment generation. Further it also enhances the productivity and efficiency of domestic companies. Thus literature on pros and cons of FDI for host countries provides the guide lines for the policy makers, so that all these positive effects could be realized to the fullest while counter affecting all the negative effects.

So the crucial role of policies related to FDI cannot be ruled out. It is in this context, that the policies towards FDI have acquired great importance. The government of various countries all over the world are continuously amending their FDI related policies to remove the hurdles to FDI inflows and ensure that it is internationally competitive. In the light of the above, the policies of the government of India have been examined in the present chapter. Since this study also makes an attempt to study FDI in Automotive Industry, the frame work of policies pertaining to FDI in automotive sector has also been examined. Accordingly this chapter is divided into two sub sections. In the first section the FDI policy in general has been discussed. This section is further sub-divided into two sub parts (i) in the first subsection evolution of the FDI policy in India since its independence has been discussed (ii) in the second sub-section the post reform scenario pertaining to FDI has been discussed. In the second section the policy related to the automotive sector has been discussed. This section is also divided into two parts, the first subsection deals with the evolution of the FDI policy related to the automotive industry in India and its influence on the automotive sector on different phases have been discussed. While in the second part ongoing FDI policy pertaining to automotive sector has been described.

I

3.2 EVOLUTION OF FDI POLICY IN INDIA:

Indian government followed a policy of planning, control and regulation for the first four decades after achieving independence from the British rule. Soon after independence, India pursued the strategy of planning for economic development. India launched the strategy of import substitution-industrialization. It focused on encouraging and improving the local capability in heavy industries. In these sectors domestic stock of created capital i.e. technology, skills, entrepreneurship were limited. This necessitated the adoption of a receptive attitude towards FDI by the government. The government made periodic attempts to reform its economic policies based on the market oriented reforms followed by developed economies. Although many factors are considered to be responsible for the policy swings of the government, however, it was the balance of payment pressures, which induced maximum policy responses. This led to exchange rate depreciation and liberalization of foreign capital inflows.

Initially the government was very cautious while approving foreign collaboration and investment, however due to the onset of foreign exchange crisis in the year 1957-58; the government had to be more liberal in its stance. In the late sixties, once again when foreign exchange situation assumed crisis proportion due to increased outflows of foreign exchange, the government resorted to a restrictive stance on foreign collaboration. Thus came a phase of light regulation and selective policy which initiated the enactment of FERA in the year 1973. By the early eighties, in the wake of second oil crisis along with India's inability to step up its manufactured export, the foreign exchange position once again weakened. The government adopted discreet measures in the eighties in an effort to attract FDI especially in high technology space and exports led manufacturing.

Once again at the beginning of nineties, the economy of India slumped into serious external debt crisis. Due to the crisis the government resorted to overall macro economic and structural adjustment with an emphasis on globalisation and economic amendments in the year 1991. The FDI policy reforms during this phase were characterised by unambiguity and the policies were much more clear and open. Indian government policy towards FDI has evolved overtime in tune with the requirements of the country in the process of development in different phases:

3.2.1 "CAUTIOUS WELCOME POLICY" (1948-66) :

At the time of its independence India did not have a specific policy on foreign capital. Foreign enterprises found it convenient to export products to India and set up their branches or subsidiaries at those places where they found it convenient and profitable. Local entrepreneurs who did not have much possibility of collaborating with foreign enterprises were either functioning on their own or obtained the services of foreign experts. After independence from the British colonial rule the new government felt the need to streamline its policy related to FDI .This need was emulated in the first policy document Industrial policy resolution 1948.

The industrial policy resolution of 1948 recognized the participation of foreign capital and enterprise, particularly as it was regarded as important because of the transfer of technology and knowledge, for faster industrialization of the country. However the government took a note that the conditions under which foreign capital would perform needed to be observed and regulated in the national interest. The then Prime Minister Pt. Jawaharlal Nehru said that once foreign capital is allowed to be invested in the country it will be treated at par with domestic capital.[1] When the country was going through the industrialization phase during 1950s foreign capital came into India through the joint venture route. The foreign exchange crisis of 1958 changed the pattern of foreign collaboration in two ways (i) foreign firms started to venture through equity participation more frequently, (ii) technical collaboration started to accept equity

[1] See Chanchal Chopra.

participation in lieu of royalties. After 1958, Indian entrepreneurs were given provisional licenses to acquire part or all of the foreign exchange through foreign investment. The streamlined was done of licensing procedure to avoid delays. Double taxation avoidance agreements were signed with Finland, Pakistan, France, U.S.A, Ceylon, Sweden, Norway, Denmark, Japan, and West Germany. In the year 1963-64, the government of India decided to give 'letter of intent' to the foreign companies to proceed with their capital project. They were no longer required to find their Indian partner first to start in order to get 'letter of intent'. Provision for additional tax concessions were provided by the instrument of The Finance Act 1965.The Act provided for the refund of capital gains tax arising from the transfer of shares held by non residents in an Indian company provided the sales proceeds were invested in India. In 1966, the government decided that investment by NRIs would be allowed without any limit in public limited industrial concerns in India. In private limited industrial concerns up to 49% share was allowed. It was however decided that in special cases it would go up to 51% provided resident Indian participation would go up to 49% within a period of 5 years. They would however be not allowed to invest in proprietorship/partnership and dividends would not be allowed to be repatriated.

In the period after 1957 however, substantial foreign investment started flowing in, even into non essential items. During the period 1957 to 1963, different sets of fiscal incentives like (concession on the rates of dividend tax for foreign investors, lowering of taxes on technical service fees at a progressive rate, and concessional tax on income from royalties) were offered to encourage foreign investors. There are also instances of FDI being permitted in industries reserved exclusively for the government sector. Further, due to the policy of encouragement and severe import restrictions imposed due to foreign exchange constraints, FDI emerged as a viable option for servicing the domestic Indian market. This is evident from the increase in number of foreign collaboration approvals from 81 in 1957 to 241 in 1965. The FDI policies, however, became increasingly regulated during the decade of the 1970s i.e. the next phase.

3.2.2 THE PERIOD OF "SELECTIVE AND RESTRICTIVE POLICY" (1967-1979) :

The government had continued with its liberal policy towards foreign capital till the mid of 1960s. However, due of its liberal policy, the outflow of remittances of profits, dividends, royalties and technical fees grew sharply. This outflow which constituted a significant portion of the foreign exchange account of the country, gave an alarming signal to the government during the late 1960s when another foreign exchange crisis surfaced. Consequently government adopted more restricted procedures for approving foreign collaboration. In the year 1968 Mudaliar committee which was looking into matters related to foreign collaboration, recommended to set up FIB (Foreign Investment Board) to deal with all foreign investment cases where the total proportion of foreign equity participation was up to 40 per cent. A subcommittee of FIB was also constituted to approve cases in which the proportion of foreign held equity was up to 25 per cent. The administrative ministries were empowered to approve cases comprising technical collaboration[2]. The outcome of the delegation of the power of approval of foreign collaborations involving up to 40 per cent foreign equity to the committee of officials, namely the FIB was the clear demarcation of authority. The proposal with more than 40 per cent foreign equity participation was forwarded to the Cabinet Committee. These guidelines encouraged the foreign equity participation up to 40 per cent and thus the phase of restricting foreign equity participation to 40 per cent commenced.

Under the new industrial licensing policy announced in February 1970, the larger industrial houses and foreign firms were permitted to setup industries in 'the core' and 'heavy investments' except industries reserved for public sector. In 1970 they established undertakings and expanded production in industries in other sectors, on the promise of undertaking specific export commitments. In 1972 -73 the government policy towards foreign investment continued to attract foreign investment in India. The

[2] See Nagesh kumar.

government followed highly restrictive policies during this period. Foreign exchange regulation act (FERA) was amended in 1973 to regulate the entry of foreign capital in the form of branches, nonresident Indian investment, and employment of foreigners in India. As per the amended rules all branches of foreign companies in India and Indian Joint stock companies in India in which non-resident interest was more than 40% were expected to bring it down to 40% within a period of two years . In those industries which needed highly sophisticated technology like core industry or tea plantation industry, non residents were allowed to carry on business with share of non-resident Indians up to 74 %. Such industries were also exempted from taking permission from RBI to carry on business within the specified licensed capacity and without any expansion and diversification of activities. In1974 foreign shipping companies were allowed to conduct their business in India. In 1976 the scheme where Non resident Indians were allowed to start industrial units in India by bringing in imported machinery was liberalised to permit equity investment up to 74 %. The permission was given to other industries as well where the investors undertook export up to 60% of the production. The capital was allowed to repatriation provided the unit started production commercially and adhered to export norms. As per the FDI policy majority of stake in any unit will be in the hands of Indians except for the project where the technology required is very sophisticated and those production units which are 100% export oriented. The government had made it clear that while it will strictly follow the provisions of FERA, the companies where non residents will decrease their holdings to less than 40% will be treated at par with Indian companies.

The Foreign Exchange Management Act (1973):

One of the policies that have influenced the operations of foreign firms more than any other policy instrument is FERA. It became the corner stone of the regulatory framework for foreign investment in later years. This law was enacted for the conservation of the foreign exchange resources and its proper utilisation in the larger interest of the economy. Section 29 of FERA that covered all existing non banking branches (FBs) and the companies incorporated under the Indian Companies Act with more than 40 per cent foreign equity participation that existed when FERA came into force on January (1974) were required to obtain RBI permission to continue their business. The permission was subject to government guide lines which required Indenisation of FBs or dilution of foreign equity in rupee companies. The organisational set up of the foreign controlled sector was changed due to these guidelines; all companies functioning were incorporated under Indian companies Act. This put a stop to the tax free repatriation of profit by FBs .Another aspect of the enforcement of FERA was that only 150 companies (including tea companies) were permitted to retain higher levels of foreign equity out of 881 companies which sought RBI permission and only these companies were under the jurisdiction of the FERA. Thus most of the foreign companies got an opportunity to become Indian and expand their business. Most of the foreign companies thus found it convenient to dilute their equity holding to 40 percent. This however did not mean that they were not foreign controlled.

3.2.3 THE PERIOD OF PARTIAL LIBERALIZATION (1980-1990) :

During the entire period of 1970s the attention of the government was focused on the implementation and enforcement of FERA. Towards the end of the decade, however India failed to significantly step up the volume and proportion of manufactured exports due to technological backwardness, limited range, inferior quality, high cost of production and a highly protected local market. The resurfacing of second oil crisis started worrying the policy makers by this time. The government authorised MNCs to set up export oriented manufacturing units in order to step up exports, liberalised the policies related to imports of capital goods and technology in order to modernise the plant and equipment. 100 percent export oriented units got a host of incentives and exemptions from taxes. The scope of MRTP Act was drastically curtailed as a part of amendment measures in 1984. In addition to the liberalisation of trade policies the government was open minded towards foreign investments and collaboration. The power to approve foreign collaboration not involving an out flow of 10 million was given to administrative ministries in 1987.

A number of steps were taken to get rid of procedural hindrances in 1989. The technical development fund Scheme was liberalised in April 1988 and March 1989 to allow for import of technology and capital goods up to the foreign exchange equivalent of Rs.30 million with a provision for further relaxation in deserving cases. Approvals for opening liaison offices by foreign companies in India were liberalised and procedures for outward remittances of royalties, technical fees and dividends were streamlined.

In order to expedite the flow of Japanese private investment and technology the government set up a fast channel in May 1988 for their speedy clearance. The government also announced measures to streamline the remittance process and exempted export profits from income tax in a bid to attract Japanese corporations to produce in India. This facility of fast channel mechanism was subsequently also extended to other major investors West Germany, USA, U.K and France[3]. A ban was imposed by the government on financial and technical collaboration in 22 categories of industries where indigenous technology was developed satisfactorily, for e.g. cement, paper, consumer goods industry etc. In the year 1982-83 government liberalized policies with regard to bank deposits and investments in equity shares of the corporate sector, the policies were liberalized further to cover preference shares and debentures issued by Indian companies. To facilitate such investment, the Reserve Bank of India also simplified the exchange control procedural formalities. In order to make up for the shortage of resources government decided to borrow from international capital market. It also permitted selective public and private sector companies to raise funds abroad. However the facilities available for deposits in non-resident account and in shares of Indian companies were confined to nonresident individuals of Indian origin or nationality. These liberalized facilities were also extended to overseas companies, partnership firms, trusts, societies and other corporate bodies in which at least 60% of the ownership interest was vested in non-resident Indians.

[3] See, kumar, 1994.

It was specified in case of investment with the facility of repatriability, that non resident Indians or overseas corporate bodies can make portfolio investment through stock exchanges in India in equity/preference shares and convertible and non convertible debentures without any limit on the quantum or value. They could also invest in the new issues of public and private sector companies in any business activity (except real estate) up to 100% of the issued shares/capital without any obligation to associate resident Indian participation in the equity capital at any time.

During 1986-87 the government permitted NRIs to subscribe to the Memorandum and Article of Association of a new company and take up their share up to the face value of Rs. 10,000 for the purpose of its incorporation. It also permitted Indian companies with more than 40% nonresident interest to acquire immovable properties in India. Further, NRIs were allowed to invest (i) up to 100% of the equity capital in sick industrial units, (ii) in new issues of Indian shipping companies under the 40% scheme (iii) in diagnostic centres in India fewer than 40% or 74% scheme. The government removed the quantitative restriction of Rs.40 lac for investment in the private limited companies by NRIs under the 40% scheme. A differential interest rate scheme was introduced with effect from 1988. In response to the above measures the investment climate in the country improved. In March1983, a delegation of U.S MNEs representative of OPIC (Overseas Private Investment Corporation) visited India to explore investment opportunities in various sectors. In 1985 April many other international institutions e.g. the European Management Foundation organised a round table on India in New Delhi which was attended by 140 top MNE executives. This meeting was followed by a number of international business delegations. The decision to liberalise the foreign investment policy led to drastic reduction in the rate of rejection of foreign approvals.

3.2.4 THE PERIOD OF "LIBERALISATION AND OPEN DOOR POLICY-(1991 ONWARDS) :

In the second half of the financial year 1990-91, India entered a period of severe balance of payments crisis, a rapid increase in external debt coupled with political uncertainty. International credit rating agencies reduced India's rating both for short and long- term borrowing. The erosion of international confidence in the Indian economy not only made borrowings in international markets difficult but also adversely affected the inflow of funds from non resident Indians. Net outflow of NRI deposits started in October 1990 and continued throughout 1991.The gulf war, further worsened the situation by putting pressure on balance of payments as there was a steep rise in petroleum price and stoppage of remittances from Indian workers in Gulf. Due to all these developments India was literally on the verge of default. The default was averted by resorting to borrowings from the IMF (International Monetary Fund) under a standby arrangement and the Compensatory and Contingency facility. It also had to mortgage gold in the Bank of England to raise additional funds.

To put its FDI policy in place the government restricted imports by making the requirement of 200 percent cash margin mandatory on the delivery of foreign exchange, reduced canalised imports, tightened the replenishment licenses to exporters, restricting the issue of new letters to import more capital goods[4]. In the year 1991 under the leadership of Prime Minister Narasimha Rao the new government implemented measures to bring macroeconomic stability and structural adjustment in order to form an economy with liberalised trade regime with a virtual absence of tariffs and licenses. The rupee was devalued twice in July 1991 as a part of reformatory measures.

A new industrial policy was announced on 24 July 1991. It abolished industrial licensing in all industries irrespective of the levels of investment except in 18 industries, mentioned in Annex II of the statement which includes hazardous chemicals, alcohol, those products which could endanger environmental and national security, and social well being.

[4] See Kumar

Foreign investment up to 51 per cent was approved automatically in 34 high priority industries identified in Annex III of the policy provided the foreign equity inflow was sufficient to cover the cost of imported capital goods.

The remittances of dividend were allowed provided they were balanced by the export earnings over a specified period of seven years from the commencement of the production. It was specified in the policy that foreign equity proposals need not be associated with foreign technology agreements. Up to 51 percent foreign equity participation was allowed where trading companies were engaged in export activities.

The new NIP approved automatic permission to foreign technology collaboration in high priority industries specified in Annex III up to a payment of 10 million. They were subjected to 8 percent payment (net of taxes) of sales over a period of 10 years after the date of agreement.

Under the MRTP Act the requirement of seeking prior approval of the government for the establishment of new undertakings or expansion of the existing one was abolished.

The government issued guidelines for ensuring proper implementation of the provisions of New Industrial policy (1991) and procedures to be followed while approving Foreign Investment.

100 percent foreign equity participation was allowed to attract MNEs in the power sector. The government allowed MNEs to explore gas fields, assist in laying pipelines and set up liquefied petroleum gas projects. Those foreign proposals that fulfilled certain parameters on capital goods imports, location and value addition were allowed automatic clearance and also given 100 per cent EOUs and units in EPZs.

Foreign Investment Promotion Board (FIPB) headed by the principal secretary to the prime minister was set up to invite and facilitate investment in India by MNEs .It was authorised to provide a single window clearance for all projects proposals considered by it. FIB and its subcommittee was abolished henceforth.

Non Resident Indians and Overseas corporate bodies were allowed up to 100 per cent equity ownership by the government in high priority industries (specified in the NIP) with repatriation benefits under the condition that the cost of the imported capital goods is covered by the equity inflow. Condition of dividend balancing was also applied. The government released provisions of raising foreign equity levels to 51 per cent of existing companies which were planning to expand their operations. The limit in respect of capital goods imports under the TDF was raised further in December 1991 to Rs 50 million.

In case of new issue of shares and convertible debentures through prospectus, they could invest up to 40% of the new capital raised with repatriation benefits. With the abolition of the list of industries which were not open for direct investment by non residents and with the addition of the hotel industries, the scope for investments by NRIs had been widened. As per the new policy, fully owned foreign enterprises were allowed to set up power projects without the requirements to balance dividend payments with export earnings. FERA companies were also given the facility of 51% equity .Companies could use foreign brand names and trademarks on goods for sale within the country. The foreign private equity in oil refinery was limited at 26%. Foreign institutional investors (FIIs) were permitted to invest in all the securities traded in the primary and secondary markets. Portfolio investments in primary and secondary markets were subjected to a ceiling of 24% of issued share capital for the total holdings of all registered FIIs, in any company. The holding of single FII was subjected to a ceiling of 5% of total issued capital. NRIs and OCBs could invest with full repatriation benefits up to 100% in high priority industries and export oriented industries and sick units and power generation.

During 1993-94 the tax rate on short term capital gains was reduced from 75% to 30%. In order to allow 100% equity participation, duty free import of capital goods and a tax holiday benefits, an Electronic Hardware Technology Park (EHTP) scheme was set up. Foreign equity participation was allowed up to 50%, in Indian companies engaged in mining activity.

Foreign investors were permitted to disinvest on an automatic basis on stock exchanges in India through a registered a stock broker, merchant banker or on private basis. NRIs were allowed to invest up to 100% on non-repatriation basis in any partnership/sole proprietorship or in private/ public limited companies (except in agricultural or plantation activities) without the approval of RBI. However OCBs were not allowed in the above sectors.

In 1994-95, the Reserve Bank of India decided to allow NRIs/OCBs and also FIIs, to invest in all activities except agriculture and plantation activities on a repatriation basis, however the limit was fixed at 24% of the new issue.

In the year 1999, Insurance Regulatory and Development Act (IRDA) was passed by the Parliament. This Act promoted private and foreign equity participation in domestic private insurance companies up to a limit of 26%.

The RBI issued a notification granting general permission to mutual funds for issuing units to NRIs/ PIOs/OCBs in March 1999. In RBI simplified the approvals in respect NRIs/ PIOs/OCBs by granting them general permission in lieu of a case by case approval procedure in a large number of areas.

Foreign owned Indian holding companies were hitherto required to obtain prior approval of the FIPB for downstream investment. They had been permitted to make such investments within permissible equity limits through the automatic route provided such holding companies bring in the requisite funds from abroad.

In February 2000, the government took a major decision to place all items under the automatic route for FDI/NRI/OCB investment except for a small negative list. This negative list included the following Items:

(i) Areas requiring an industrial license under the Industries development and Regulation act, 1951;(ii) The manufacturing units being reserved for small scale industries,(iii) All areas requiring industrial license in terms of location policy notified under the New Industrial Policy of 1991, (iv) Proposals having previous venture /tie up in India with foreign collaborator,(v) Proposals related to acquisition of shares in existing Indian companies by foreign /NRI/OCB investors.(vi) Proposals falling outside notified sectoral policy/caps or under sectors in which FDI is not permitted and/ or applications chosen to be submitted through FIPB rather than automatic route by the investor.

This was an important step to dispense with case by case approval procedure and to impart greater transparency in the process of foreign investment.

In the year 2000-2001, FDI up to 100% was allowed in the e-commerce subject to specific conditions. 100% FDI had been allowed in the telecommunications sector for internet Service Providers not providing gateways, infrastructure providers providing dark fiber, electronic mail and Voice mail.

FDI up to 100% is permitted in airports with FDI above 74 % subject to prior approval of the government. The defense industry sector has also opened up to 100% for Indian private sector participation with FDI permitted up to 26%, both subject to licensing. FDI up to 100% with prior government approval is allowed in courier services. FDI up to 100% is allowed on the automatic route for Mass Rapid Transport System in all metropolitan cities. FDI up to 100% on automatic route is permitted in drugs and pharmaceuticals. Other significant changes include allowing payment of royalty up to 20% of exports and 1% on domestic trade under automatic route on the use of trademarks and brand names of foreign collaborators without technology transfer. In the year 2002 some radical recommendations were made by the N.K. Singh committee on foreign direct investment. Some of these recommendations include hiking the sectoral caps for FDI. The committee also recommended empowering the Foreign Investment Promotion Board and Foreign Investment Implementation Authority to expedite the process of administrative and policy approvals. It was this committee that suggested the development of the special economic zones as the most competitive destinations for export related FDI by simplifying laws, rules, administrative procedures and reducing the bureaucratic delays. Thus the comprehensive changes introduced in the year 1991 marked a complete change from the past, which provided much freedom to the foreign investors.

Under the ongoing policy phase the emphasis is on greater access to foreign capital, technology, the slowdown in the growth rate of Indian economy commensurate with the global recession, it is very challenging under the present circumstances to attract FDI into the economy. Further to add to the problems is the political uncertainty that prevails in India as most of the market players are holding back for a while now in order to get a clearer picture after the lok sabha elections. Under the ongoing policy FDI is permitted in almost all manufacturing industries except some key and strategic sectors of national interest.

3.2.5 FDI POLICY OF THE GOVERNMENT OF INDIA IMPLEMENTED ON 17th APRIL 2014:

The government has on 17th April put in place a policy framework on Foreign Direct Investment which is transparent, predictable and easily comprehensible. This framework is embodied in the Circular on Consolidated FDI policy, The present consolidation subsumes and supersedes all Press Notes/Press Releases /Clarifications/Circulars issued by DIPP, which were in force as on April 16,2014 and reflects the FDI policy as on April 17 2014. This Circular accordingly became effective from April 17, 2014. Reference to any statute or legislation made in this Circular shall include modification, amendments or re-enactments thereof. The Government has reviewed the caps and /or routes in various sectors.

3.3. GENERAL CONDITIONS ON FDI :

3.3.1 WHO CAN INVEST IN INDIA ?

1. A nonresident entity can invest in India subject to the FDI policy except in those sectors /activities which are prohibited.

However a citizen of Bangladesh or an entity incorporated in Bangladesh can invest only under the government route. Further a citizen of Pakistan or an entity incorporated in Pakistan can invest only under the Government route, in sectors/activities other than defense, space and atomic energy and sectors/activities prohibited for foreign investment.

2. NRI residents in Nepal and Bhutan as well as citizens of Nepal and Bhutan are permitted to invest in the capital of Indian companies on repatriation basis, subject to the condition that the amount of consideration for such investment shall be paid only by way of inward remittance in free foreign exchange through normal banking channels.

3. OCBs have been derecognised as a class of investors in India with effect from September 16, 2003. Erstwhile OCBs which are incorporated outside India and are not under the adverse notice of RBI can make fresh investment under FDI policy as incorporated non–resident entities, with the prior approval of Government of India if the investment is through Government route and with the prior approval of RBI if the investment is through Automatic route.

4. **(i)** An FII may invest in the capital of an Indian Company under the portfolio Investment Scheme which limits the individual holding of an FII to 10 % of the capital of the company and the aggregate limit of 24 % of the capital of the company .This aggregate limit of 24% can be increased to the sectoral cap/statutory ceiling as applicable by the Indian Company concerned through a resolution by its Board of Directors followed by a resolution to that effect by its General Body and subject to prior intimation to RBI .The aggregate FII investment in the FDI and portfolio Investment should be within the above caps.

(ii) The Indian company which has issued shares to FIIs under policy for which the payment has been received directly into company's account should report these figures separately under item no.5 of Form FC-GPR (Annex-1)

(iii) A daily statement with respect to all transactions (except derivative trade) has to be submitted by the custodian bank in floppy/soft copy in the prescribed format directly to RBI and also uploaded directly on the OFRS web site. (http://secweb.rbi.org.in/orfs Main Web/Login.jsp)

5. Only SEBI registered FII and NRIs as per Schedules 2 and 3 respectively of Foreign Exchange Management (Transfer and Issue of security by a Person Resident outside India) Regulation 2000, can invest/trade through a registered broker in the capital of Indian Companies on recognised Indian Stock Exchanges.

6. A SEBI registered Foreign Venture Capital Investor (FVCI) may contribute up to 100% of the capital of an Indian Venture Capital Undertaking (IVCU) and may also set up a domestic asset management company to manage the fund. All such investments can be made under the automatic route in terms of Schedule 6 to Notifications No. FEMA 20. A SEBI registered FVCI can invest in a domestic venture capital fund registered under the SEBI (Venture Capital Fund) Regulation 1996. Such investments would also be subject to the extant FEMA regulations and extant FDI policy including sectoral caps, etc. SEBI registered FVCIs are also allowed to invests under the FDI scheme, as nonresident entities, in other companies, subject to FDI policy and FEMA regulations.

Further , FVCIs are allowed to invest in the eligible securities (equity, equity linked instruments ,debt , debt instruments , debentures of an IVCU or VCF , units of schemes / funds set up by a VCF) by way of private arrangement/purchase from a third party also, subject to terms and conditions as stipulated in Schedule 6 of notification No. FEMA 20/2000-RB dated May 3, 2000 as amended from time to time. It is also being clarified that SEBI registered FVCIs would also be allowed to invest in securities on a recognized stock exchange subject to the provisions of the SEBI (FVCI) Regulations, 2000, as amended from time to time as well as the terms and conditions stipulated therein.

7. QUALIFIED FOREIGN INVESTOR (QFIS) INVESTMENT IN EQUITY SHARE:

7.1 QFIs are permitted to invest through SEBI registered Depository Participants (DPs) only in equity shares of listed Indian companies through recognised brokers on recognised stock exchanges in India as well as in equity shares of Indian companies which are offered to public in India in terms of the relevant and applicable SEBI guidelines /regulations.

7.2 The individual and aggregate investment limits for the QFI shall be 5% and 10 % respectively of the paid up capital of an Indian company. These limits shall be over and above the FII and NRI investment ceilings.

7.3 Dividend payment on equity shares held by QFIs can either be directly remitted to the designated overseas bank accounts of the QFIs or credited to the single noninterest bearing Rupee account. They shall be remitted to the designated overseas bank accounts of the QFIs within five working days .Within five working days, the dividend payments can be also utilized for fresh purchases of equity shares under this scheme, if so instructed by the QFI .

3.3.2 ENTITIES INTO WHICH FDI CAN BE MADE

1. FDI in an Indian Company: Indian companies can issue capital against FDI

2. FDI in Partnership Firm/Proprietary Concern:

   (i) A Nonresident Indian (NRI) or a Person of Indian Origin (PIO) resident outside India can invest in the capital of a firm or a proprietary concern in India on non repatriation basis provided;

   (a) Amount is invested by inward remittance or out of NRE/FCNR (B)/NRO account maintained with Authorised Dealers/Authorised banks.

   (b) The firm or proprietary concern is not engaged in any agricultural /plantation or real estate business or print media sector.

   (c) Amount invested shall not be eligible for repatriation outside India.

   (ii) Investments with repatriation option: NRIs /PIO may seek prior permission of Reserve Bank for investment in sole proprietorship concerns /partnership with firms with repatriation option. The application will be decided in consultation with the government of India.

   (iii) Investment by non residents other than NRIs /PIO: A person resident outside India other than NRIs/PIO may make an application and seek prior approval of Reserve Bank for making investment in the capital of a firm or a proprietorship concerns or ant association of persons in India. The application will be decided in consultation with the Government of India.

   (iv) Restrictions: An NRI or PIO is not allowed to invest in a firm or proprietorship concern engaged in any agricultural/plantation activity or real estate business or print media.

3.3.3 TYPES OF INSTRUMENT

1. Indian companies can issue equity shares, fully, compulsorily and mandatorily convertible debentures and fully, compulsorily and mandatorily convertible preference shares subject to pricing guidelines/valuation norms prescribed under FEMA Regulation. The price /conversion formula of convertible capital instruments should be determined upfront at the time of issue of the instruments. The price at the time of conversion should not be in any case lower than the fair value worked out at the time of issuance of such instruments, in accordance with the extant FEMA regulations.

2. Other types of Preference shares /Debentures i.e. non convertible, optionally convertible or partially convertible for issue of which funds have been received on or after May 1, 2007 are considered as debt. Accordingly all norms applicable for ECBs relating to eligible borrowers, recognised lenders, amount and maturity, end- use stipulations, etc shall apply. Since these instruments would be denominated in rupees, the rupee interest rate will be based on swap equivalent of London Interbank Offered Rate (LIBOR) plus the spread as permissible for ECBs of corresponding maturity.

3. The inward remittance received by the Indian company vide issuance of DRs and FCCBs are treated as FDI and counted towards FDI.

4. Issue of shares by Indian Companies under FCCB/ADR/GDR

(i) Indian companies can raise foreign currency resources abroad through the issue of FCCB/DR (ADRs/GDRs), in accordance with the scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India there under from time to time.

(ii) A company can issue ADRs/GDRs if it is eligible to issue shares to persons resident outside India under the FDI Policy.

However, an Indian listed company, which is not eligible to raise funds from the Indian Capital Market including a company which has been restrained from accessing the securities market by the securities and exchange board of India (SEBI) will not be eligible to issue ADRs/GDRs.

(iii) Unlisted companies which have not yet accessed the ADR/GDR route for raising capital in the international market would require prior or simultaneous listing in the domestic market while seeking to issue such overseas instruments. Unlisted companies, which have already issued ADRs/GDRs in the international market, have to list in the domestic market on making profit or within three years of such issue of ADRs/GDRs, whichever is earlier. ADRs/GDRs are issued on the basis of the ratio worked out by the Indian company in consultation with the lead manager to the issue. The proceeds so raised have to be kept abroad till actually required in India. Pending repatriation or utilization of the proceeds, the Indian company can invest the funds in:-

(a) Deposits, Certificate of Deposits or other instruments offered by banks rated by standard and poor , Fitch , IBCA, Moody’s ,etc. with rating not below the rating stipulated by Reserve Bank from time to time for the purpose;

(b) Deposits with branch /es of Indian Authorised Dealers outside India; and

(c) Treasury bills and other monetary instruments with a maturity or unexpired maturity of one year or less.

(iv) There are no end use restrictions except for a ban on investment of such funds in real estate or the stock market. There is no monetary limit up to which an Indian company can raise ADRs/GDRs.

(v) The ADR/GDR proceeds can be utilized for first stage acquisition of shares in the disinvestment process of Public Sector Undertakings /Enterprises and also in the mandatory second stage offer to the public in view of their strategic importance.

(vi) Voting rights on shares issued under the Scheme shall be as per the provisions of Companies Act, 1956 and in a manner in which restrictions on voting rights imposed on ADR/GDR issues shall be consistent with the Company Law provisions. Voting rights in the case of banking companies will continue to be in terms of the provisions of the Banking Regulation Act 1949, and the instructions issued by the RBI from time to time as applicable to the share holders exercising voting rights.

(vii) Erstwhile OCBs who are not eligible to invest in India and entities prohibited from buying, selling or dealing in securities by SEBI will not be eligible to subscribe to ADRs/GDRs issued by Indian companies.

(viii) The pricing of ADR/GDR issues should be made at a price determined under the provision of the Scheme of issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme 1993 and guidelines issued by the Government of India and Directions issued by the Reserve Bank from time to time.

(ix) The pricing of sponsored ADRs/GDRs would be determined under the provisions of the Scheme of issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India and directions issued by the Reserve Bank from time to time.

3.3.4 ISSUE /TRANSFER OF SHARES :

1. The capital instruments should be issued within 180 days from the date of receipt of the inward remittance received through normal banking channels including escrow account opened and maintained for the purpose of by debit to the NRE/FCNR (B) account of the nonresident investor. In case, the capital instruments are not issued within 180 days from the date of receipt of the inward or date of Debit to the NRE/FCNR (B) account, the amount of consideration so received should be refunded immediately to the nonresident investor by outward remittance through normal banking channels or by credit to the NRE/FCNR (B) account as the case may be. Non compliance with the above provision would be reckoned as a contravention under FEMA and would attract penal provision. In exceptional cases, refund of the amount of consideration outstanding beyond a period of 180 days from the date of receipt may be considered by the RBI, on the merits of the case.

2. Issue Price of shares - Price of shares issued to persons resident outside India under the FDI policy, shall not be less than:

a. The price worked out in accordance with the SEBI guidelines, as applicable , where the shares of the company is listed on any recognised stock exchange in India;

b. The fair valuation of shares done by an SEBI registered Category –I Merchant Banker or a Chartered Accountant as per the discounted free cash flow method, where the shares of the company are not listed on any recognised stock exchange in India; and

c. The price as applicable to transfer of shares from resident to nonresident as per the pricing guidelines laid down by the Reserve Back from time to time, where the issue of shares is on preferential allotment.

However, where non –residents (including NRIs) are making investments in an Indian company in compliance with the provision of the companies act, 1956; by the way of subscription to its Memorandum of Association, such investments may be made at face value subject to their eligibility to invest under FDI scheme.

3. **Foreign Currency Account-** Indian companies which are eligible to issue shares to persons resident outside India under the FDI policy may be allowed to retain the share subscription amount in a foreign Currency Account with the prior approval of RBI.

3.4. FOREIGN INVESTMENT:

Foreign investment shall include all types of foreign investment i.e. FDI, investment by FIIs, NRIs, ADRs, GDRs, Foreign Currency Convertible Bonds (FCCB) and fully, mandatorily & compulsorily convertible preference shares/debentures, regardless of whether the said investments have been made under Schedule 1, 2, 3 and 6 of FEMA (Transfer or issue of shares by Person Resident Outside India) Regulations.

3.4.1 CAPS ON INVESTMENT :

Investment can be made by non residents in the capital of a resident entity only to the extent of the percentage of the total capital as specified in the FDI policy. The caps in various sectors are detailed in consolidated FDI policy by DIPP which are mentioned in the subsequent paragraph.

Sectoral Caps for FDI in some important sectors as per Consolidated FDI policy (Effective from April 17, 2014)[5]

Defense: Defense Industry is subject to Industrial license under the Industries (Development &Regulation) Act, 1951. In this sector up to 26% is allowed through Government route, above 26% through Cabinet Committee on Security (CCS) on case to case where ever likely to result in access to modern and 'state of-art' technology in the country.

[5] For further detail See Consolidated FDI Policy Effective from April 17, 2014

Note:

(i) Investment by Foreign Portfolio Investors FPIs/FIIs (through portfolio investment) is not permitted in defense sector.

(ii) FPI/FII (through portfolio investment) in companies holding defence remain capped at the level existing as on the said date. No fresh FPI/FII (through portfolio investment) is permitted.

Broadcasting Carriage Services:

FDI Up to 74% allowed. Out of this up to 49% through Automatic. Beyond 49 % and up to 74% through Government route. Broadcasting services include

(1) Teleports (setting up of up-linking)

(2) Direct to Home (DTH);

(3) Cable Networks (Multi System operators (MSOs) operating at National or State or District level and undertaking up gradation of networks towards digitalization and addressability);

(4) Mobile TV

(5) Headend-in-the Sky Broadcasting Service (HITS)

Print Media:

FDI and investment by NRIs/PIOs/FII/FPI up to 26% through Government route is allowed to publish news papers and periodicals dealing with news and current affairs and also FDI and investment by NRIs/PIOs/FII/FPI up to 26% through Government route are allowed to publish Indian editions of foreign magazines dealing with news and current affairs. 100% FDI through government route is allowed for publishing/printing of scientific and technical magazines/specialty journals/ and periodicals, subject to compliance with the legal framework as applicable and guidelines issued in this regard from time to time by Ministry of Information and Broadcasting.

Airports:

(a) 100 % FDI for Greenfield projects through automatic route is allowed.

(b) 100% FDI in existing projects is allowed. Here up to 74% is through automatic route Government route is beyond 74%.

Air Transport Services:

(1) 49% FDI (100% for NRIs) through automatic route is allowed for scheduled Air Transport Service/ Domestic Scheduled Passenger Airline.

(2) 74% FDI is allowed for non-Scheduled Air Transport Service. Out of this up to 49% is through automatic route and beyond 49% and up to 74% is through government route.

(3) Helicopter services /seaplane services requiring DGCA approval have 100% FDI through automatic route.

Construction Development: Townships, Housing, Built-up infrastructure

100 % FDI through automatic route is allowed in this sector.

Industrial Parks –In new and existing industrial parks 100% FDI through automatic route is allowed (i) “Industrial Park” is a project in which quality infrastructure in the form of plots of developed land or built up space or a combination with common facilities is developed and made available to all the allottee units for the purposes of industrial activity.

Cash & Carry Wholesale Trading/Wholesale Trading (including sourcing from MSEs)

100% FDI through automatic route.

Guidelines for Cash & Carry Wholesale Trading/Wholesale Trading (WT):

For undertaking WT, requisite licenses/registration/ permits, as specified under the relevant Acts/Regulations/Rules/Orders of the State Government/Government Body/Government Authority/Local Self-Government Body under that State Government should be obtained.

E commerce India's Foreign Direct Investment policy restricts e-commerce companies from offering services directly to retail consumers. At present, 100 per cent FDI is allowed in business -to-business (B2B) e-commerce but not in retail trading.

Mining and Petroleum & Natural Gas

Mining and Exploration of metal and non-metal ores including diamond, gold etc.

100% through automatic route.

Coal and Lignite

In the area of Coal & Lignite mining for captive consumption by power projects, iron & steel and cement units and other eligible activities permitted under and subject to the provisions of Coal Mines (Nationalization) Act, 1973, 100 % FDI is allowed through automatic route.

100% FDI through automatic route 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.

Petroleum & Natural Gas

For exploration activities of oil and natural gas fields, infrastructure related to marketing of petroleum products and natural gas, marketing of natural gas and petroleum products, petroleum product pipelines, natural gas/pipelines, LNG Regasification infrastructure, etc.100% FDI through automatic route is allowed.

Manufacture of items reserved for production in Micro and Small Enterprises

FDI in MSEs (as defined under Micro, Small and Medium Enterprises Development Act, 2006 (MSMED, Act 2006)) will be subject to the sectoral caps, entry routes and other relevant sectoral regulations. Any industrial undertaking which is not a Micro or Small Scale Enterprise, but manufactures items reserved for the MSE sector would require Government route where foreign investment is more than 24% in the capital. Such an undertaking would also require an Industrial License under the Industries (Development & Regulation) Act, 1951 for such manufacture.

Single Brand product retail trading

In this field 100% FDI is allowed. Automatic up to 49% and beyond 49% through Government route. Foreign Investment in Single Brand product retail trading is aimed at attracting investments in production and marketing, improving the availability of such goods for the consumer, encouraging increased sourcing of goods from India, and enhancing competitiveness of Indian enterprises through access to global designs, technologies and management practices.

In respect to proposals involving FDI beyond 51%, sourcing of 30% of the value of goods purchased will be done from India, preferably from MSMEs, village and cottage industries, artisans and craftsmen, in all sectors.

Multi Brand Retail Trading

In this sector 51 % FDI through government route is allowed.

(1) FDI in multi brand retail trading in all products will be permitted, subject to the following conditions:

(i) Fresh agricultural produce, including fruits, vegetables, flowers, grains, pulses, fresh poultry, fishery and meat products, may be unbranded.

(ii) Minimum amount to be brought in as FDI by the foreign investor, would be US $ 100 million.

Banking- Private Sector

In this sector FDI up to 74% including investment by FIIs/FPIs is allowed. Out of this up to 49% Automatic and beyond 49% and up to 74% through Government route.

3.4.2 ENTRY CONDITIONS ON INVESTMENT :

Investment by non residents can be permitted in the capital of a resident entity in certain sectors/activity with entry conditions. Such conditions may include norms for minimum capitalization, lock–in period, etc.

3.4.3 OTHER CONDITIONS ON INVESTMENT BESIDES ENTRY CONDITIONS :

Besides the entry conditions on foreign investment , the investment / investors are required to comply with all relevant sectoral laws, regulations, rules, security conditions, and state /local laws/regulations.

1. Foreign Investment into an Indian company engaged only in the activity of investing in the capital of other Indian company/ies (regardless of its ownership or control): Foreign investment into an Indian company, engaged only in the activity of investing in the capital of other Indian company/ies, will require prior Government/FIPB approval, regardless of the amount or extent of foreign investment. Foreign investment into Non Banking Finance Companies (NBFCs) carrying on activities approved for FDI will be subject to the specified conditions by DIPP.

2. Those companies which are core investment companies (CICs) will have to additionally follow RBIs Regulatory Framework for CICs.

3. For infusion of foreign investment into an Indian company which does not have any operations and also does not have any downstream investments, (Downstream investment means indirect foreign investment by one Indian company into another Indian company by way of subscription or acquisition), Government /FIPB approval would be required regardless of the amount of or extent of foreign investment.

3.4.4. ENTRY ROUTES FOR FDI :

Investments can be made by non residents through the automatic route or the Government route. Under the automatic route, the non-resident investor or the Indian company does not require any approval from Government of India for the investment. Under the government route prior approval of the government of India is required. Proposals for foreign investment under Government route are considered by FIPB.

1. Automatic route:

Companies proposing foreign investment under the automatic route do not require any government approval, provided the proposed foreign equity is within the specified ceiling and the requisite documents are filled with the RBI within 30 days of receipt of funds. Post facto filing of data relating to the investment made with the RBI are for record and data purposes. The automatic route encompasses all proposals where the proposed items of manufacture /activity do not require an industrial licence and it is not reserved for the small scale sector.

The automatic approval route of the RBI was introduced to facilitate FDI inflows. However, during the post policy period, the actual investment flows through the automatic route of the RBI against total FDI flows remained rather insignificant. This was partly due to the fact that the crucial areas like Electronics, services and minerals were left out of the automatic approval route. Another limitation was the ceiling of 51 percent on foreign equity holding. An increasing number of proposals were cleared through the FIPB route while the automatic approval route was relatively unimportant. However since 2000 automatic approval route has become significant and accounts for a large part of FDI flows.

2. *Government Approval:*

For the following categories, government approval for FDI through the Foreign Investment Promotion Board (FIPB) is necessary:

(i) Proposal attracting compulsory licensing.

(ii) Items of manufacturing reserved for the small scale sector.

(iii) Acquisition of the existing shares.

FIPB ensures a single window approval for the investment and acts as a screening agency (for sensitive /negative list sectors). FIPB approvals (or rejections) are normally received in 30 days. Some foreign investors use the FIPB application route where there may be absence of stated policy or lack of policy clarity.

Guidelines have been issued for the establishment of Indian companies /transfer of ownership or control of Indian companies, from resident Indian citizens to nonresident entities. In sectors /activities with caps- including, inter alia, defense production, air transport services, ground handling services, asset reconstruction companies, private sector banking, broadcasting, commodity exchanges, credit information companies , insurance , print media, telecommunications and satellites, Government approval/FIPB approval is required in all cases where:

An Indian Company is being established with foreign investment and is owned by a non resident entity or;

An Indian company is being established with foreign investment and is being controlled by a non-resident entity or;

The control of an existing Indian company –currently owned or controlled by resident Indian citizens and Indian companies, which are owned or controlled by resident Indian citizens –will be /is being transferred /passed on to a non resident entity as a consequence of transfer of shares and /or fresh issue of shares to non-resident entities through amalgamation, merger /demerger, acquisition etc. Or;

The ownership of an existing Indian company –currently owned or controlled by resident Indian citizens and Indian companies, which are owned or controlled by resident Indian citizens –will be /is being transferred/passed on to a non resident entity as a consequence of transfer of shares and /or fresh issue of shares to nonresident entities through amalgamation, merger/demerger, acquisition etc.

These guidelines do not apply to sectors/activities where there are no foreign investment caps, that is, 100 percent foreign investment is permitted under the automatic route.

As already noted, FDI in a particular industry may, however, be made through (a) the automatic under powers delegated to the RBI or (b) with the approval accorded by the FIPB. The automatic route means that foreign investors only need to inform the RBI within 30 days of bringing in their investment and again within 30 days of issuing shares. Companies getting foreign investment approval through FIPB route do not require any further clearance from RBI for the purpose of receiving inward remittance and issue of shares to foreign investors. RBI has granted general permission under FEMA with respect to proposals approved by the FIPB. Such companies are however required to notify the concerned regional office of the RBI of receipt of inward remittances within 30 days of such receipts and again within 30 days of issue of shares to the foreign investors.

3.5. FOREIGN INVESTMENT PROMOTION BOARD (FIPB):

FIPB is the nodal agency of considering all proposals requiring prior government approval.

1. ***Levels of approvals for Cases under Government Route:***

   The Minister of Finance who is in charge of FIPB considers the recommendations of FIPB on proposals with total foreign equity inflow of and below Rs. 1,200 crore. The recommendations of FIPB on proposals with total foreign equity flow of more than Rs.1200 crore are placed for consideration of Cabinet Committee on Economic Affairs (CCEA).

   The CCEA considers proposals which may be referred to it by the FIPB/Minister of Finance (in charge of FIPB).

2. ***Cases which do not require Fresh Approval:***

   Companies may not require fresh prior approval of the Government, i.e. Minister in-charge OF FIPB/CCEA for bringing in additional foreign investment into the same entity, in the following cases:

   a. Entities the activities of which had earlier required prior approval of FIPB/CCFI/CCEA and which had, accordingly, earlier obtained prior approval of FIPB/CCFI/CCEA for their initial foreign investment but subsequently such activities/sectors have been placed under automatic route.

   b. Entities the activities of which had sectoral caps earlier and which had accordingly, earlier obtained prior approval of FIPB/CCFI/CCEA for their initial foreign investment but subsequently such caps were removed/increased and the activities placed under the automatic route; provided that such additional investment along with the initial /original investment does not exceed the sectoral caps.

c. Additional foreign investment into the same entity where prior approval of FIPB/CCFI/CCEA had been obtained earlier for the initial /original foreign investment due to certain requirements and approval of the Government under the FDI policy is not required for any other reason /purpose.

Although MNEs /OCBs enjoy the same status as domestic companies, they face restriction by way of limitations imposed in respect to holdings in different sectors vis-a vis the domestic company. Apart from discrimination arising from sectoral caps on foreign equity holdings, the other differences between the foreign investor and a domestic investor arise from the following:

- The foreign investor has to obtain FIPB approval in regard to all proposals in which the foreign collaborator has a previous venture /tie up in India.
- The foreign collaborator has to obtain FIPB approval in regard to all proposals relating to acquisition of existing shares in an Indian company/ takeovers.
- Mergers /amalgamation of companies require the approval of both the FIPB and the RBI.
- Investment s and returns are not freely repatriable in certain cases and are subject to conditions such as lock in period on original investment, dividend cap etc.

3.6. POST APPROVAL PROCEDURES :

1. **Project Clearances:** After the approval has been obtained, the applicant may get his unit /company registered with the Registrar of Company. Subsequently, the company needs to obtain various clearances such as land clearance, building design clearance, pre-construction clearance, labour clearance etc. From different authorities before beginning its operations. These clearances differ from sector to sector and may also differ from state to state.

2. **Registration and Inspection:** Each industrial unit is supposed to maintain records in regard to production, sale and export, use of specified raw materials including public utilities like water and electricity, labour related details, financial details and details in regard to industrial safety and environment.

   The unit is also subject to periodic inspection by the factory inspector, labour inspector, food inspector, fire inspector central excise inspector, air and water inspector, mines inspector, city inspector and the like.

3. **Foreign Exchange Management Act (FEMA), 1999:** The additional provisions which apply only to entry of FDI emanate from the provisions of FEMA. According to FEMA, no person resident outside India shall without the approval/knowledge of the RBI may establish in India a branch or a liaison office or a project office or any other place of business.

3.7. ENTRY OPTIONS FOR FOREIGN INVESTORS :

A foreign company planning to set up business operations in India has the following options:

1. ***Incorporate a company under the Companies Act, 1956 through:***

   (i) Joint Venture

   (ii) Wholly –owned subsidiary

   Foreign equity in such Indian companies can be up to 100 percent depending on the requirements of the investor, subject to equity caps in respect of the sector/area of activities under the FDI policy.

2. ***Enter as a foreign company through:***

   (i) Liaison office /representative office.

   (ii) Project office

   (iii) Branch office

   Such offices can undertake activities permitted under the Foreign Exchange Management Regulations, 1999.

a. **Liaison office /Representative office:** The role of the liaison office is limited to collecting information about the company and its products and disseminating it to prospective Indian customers.

b. **Project Office:** Foreign companies planning to execute specific projects in India can set up temporary project /site offices in India. The RBI has now granted general permission to foreign entities to establish project offices subject to specified conditions.

c. **Branch Office:** Foreign companies engaged in manufacturing and trading activities abroad are allowed to set up branch offices in India for the following purposes:

1. Export/Import of goods
2. Rendering professional or consultancy services.
3. Carrying out research in which the parent company is engaged.
4. Promoting technical or financial collaboration between Indian companies and parent or overseas group company
5. Representing the parent company in India and acting as buying /selling agent in India
6. Rendering services in information technology and development of software in India.
7. Rendering technical support to the products supplied by the parent/group companies
8. Foreign airline /shipping company.

A branch office is not allowed to carry out manufacturing activities on its own but is permitted to sub-contract these to an Indian manufacturer; Branch offices established with the approval of the RBI may remit outside India the profit of the branch net of applicable Indian taxes and subject to RBI guidelines.

3. ***Branch Office On Standalone Basis In Special Economic Zones* (SEZs):** Such branch would be restricted to SEZ and no business activity /transaction will be allowed outside the SEZ in India, which include branch subsidiaries of parent office in India.

4. ***Investment In A Firm Or A Proprietary Concern By* NRIs:** A Non Resident Indian (NRI) or a Person of Indian Origin (PIO) resident outside India may invest by way of contribution to the capital of a firm or a proprietary concern in India on non –repatriation basis provided:

   (i) The amount is invested by inward remittances or out of specified account types (NRE/FCNR/NRO accounts) maintained with an Authorised Dealer.

   (ii) The firm or proprietary concern is not engaged in any agricultural / plantation or real estate business, i.e. dealing in land and immovable property with a view to earning profit or earning income there from.

   (iii)The amount invested shall not be eligible for repatriation outside India. NRIs/PIOs may invest in sole proprietorship concerns/partnership firms with repatriation benefits with the approval of Government /RBI.

5. ***Investment In A Firm Or A Proprietary Concern By Other Than* NRIs:** No person outside India other than NRIs/PIO shall make any investment by way of contribution to the capital of a firm or a proprietorship concern or any association of persons in India. The RBI may, on an application made to it, permit a person resident outside India to make such an investment subject to such terms and conditions as may be considered necessary.

6. ***Foreign Technology Agreements* :** Foreign technology induction is encouraged both through FDI and through foreign technology agreements .India has one of the most liberal policy regimes in regard to technology agreements .Foreign technology collaborations are permitted either through automatic route or through FIPB.

3.7.1. AUTOMATIC APPROVAL:

RBI accords automatic approval for foreign technology collaboration agreements for all industries subject to the following:

1. Lump sum payment should not exceed US$ 2 million.

2. Royalty payable is limited to 5 percent for domestic sales and 8 percent for exports subject to total payment of 8 percent on sales over a 10- year period.

3. The period for payment of Royalty not to exceed 7 years from the date of commencement of commercial production or 10 years from the date of agreement whichever is earlier.

3.7.2 FIPB ROUTE:

For the following categories, Government approval is necessary:

1. Proposal attracting compulsory licensing.

2. Items of manufacture reserved for the small scale sector.

3. Proposal involving any previous joint venture or technology transfer /trade mark agreement in the same or allied field in India.

4. Extension of foreign technology collaboration agreements (including those cases which may have received automatic approval in the first instance.

5. Proposal not meeting any or all of the parameters for automatic approval.

The different components of foreign technology collaboration such as technical know-how fees, Payment for design and drawing , payment for engineering service and royalty are eligible for approval through the automatic route and by the government .Payments for hiring of foreign technicians, deputation of Indian technicians abroad ,and testing of indigenous raw material, products, indigenously developed technology in foreign countries are, however, governed by separate RBI procedures and rules and are not covered by the foreign technology collaboration approval. Similarly, payments for imports of plant and machinery and raw material are also not covered by foreign technology collaboration approval for which RBI is the competent authority.

To sum up, subject to certain foreign equity conditions, a foreign company can set up a registered company in India and operate under the same laws, rules and regulations as applicable to an Indian owned company .Unlike many countries including China, India extends National Treatment to foreign investors .There is no discrimination against foreign companies registered in India or in favour of domestic owned ones. The condition is explicit and transparent unlike many hidden conditions imposed by some other recipients of FDI .There are a few prudential conditions on the sale of shares in unlisted companies and the above market price sale of shares in public companies.

3.8. FDI REGULATION, PROMOTION AND FACILITATION :

Regulatory Framework

The institutional bodies regulating capital floes include the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Forward Market Commission (FMC), Insurance Regulatory and development Authority (IRDA) and Pension Fund Regulatory and Development Authority. Within the Government of India, the Ministry of Finance houses the department of Revenue, Department of Economic Affairs (DEA) and Department of Financial Services .The department of revenue hosts the central Board of Direct Taxes (CBDT); DEA hosts the capital Markets Division while the department of financial Services deals with banks, insurance and pension funds and their respective regulators. The Finance Minister heads the Foreign Investment Promotion Board 9FIPB) which approves foreign direct investment, on a case by case basis, into the country.

The ministry of Commerce and Ministry of Finance host the department of Industrial policy and promotion (DIPP) which is responsible for promulgating policy on foreign direct investment into the country.

The RBI is given primary authority to regulate capital flows through the Foreign Exchange Management Act (FEMA) 1999. Notably, Section6 of FEMA authorizes the RBI to manage foreign exchange transaction s and capital flows in consultation with the Ministry of Finance, The Banking Act, 1949 and the RBI Act 1934 also provide the RBI with supporting authority to regulate capital flow.

3.9 FOREIGN INVESTMENT PROMOTION BOARD (FIPB) :

FIPB is the nodal agency for consideration of all proposals requiring prior Government approval. FIPB is especially empowered to engage in purposive negotiation and also consider proposal in totality free from predetermined parameters on procedures.

FIPB comprises of the following Secretaries to the Government of India:

1. Secretary to Government, Department of Economic Affairs, Ministry of Finance (Chairperson).

2. Secretary to Government, Department of Industrial policy and Promotion, Ministry of Commerce and Industry.

3. Secretary to Government, Department of Commerce, Ministry of Commerce and Industry.

4. Secretary to Government, Economic relation, Ministry of External Affairs

5. Secretary to Government, Ministry of Overseas Indian Affairs.

The Board can co-opt other Secretaries to the Central Government and top officials of financial institutions, banks and professional experts of Industry and Commerce, as and when necessary.

FIPB provides for a time bound and transparent mechanism for considering proposals requiring government approval. Foreign investment proposals received in the Department of Economic Affair are placed before the FIPB within 15 days of its receipt .Government approval is granted within 8 weeks of filing of a complete application.

The recommendations of the FIPB in respect of project proposals involving a total investment of up to Rs. 1200 crore are considered and approved by the Finance Minister .Project with a total investment exceeding Rs.1200 crore are submitted to the Cabinet Committee on Economic affairs (CCEA)for decision.

Indian companies getting foreign investment approval through FIPB routes do not require any further clearance from RBI for the purpose of receiving inward remittance and issue of shares to the foreign investor. Such companies are however, required to notify the concerned Regional Office of the RBI of receipt of inward remittances within 30 days of such receipt and to file the required document with the concerned Regional office s of RBI within 30 days after issue of shares to the foreign investors.

It is noteworthy that the delays are not at the stage of FDI approval per se i.e. at the entry point whether through RBI automatic route or FIPB approval .The FIPB considers application on the basis of notified guidelines and disposes them within a 6-8 week timeframe as has been laid down by the cabinet .The entire process of FIPB applications ,starting from their registration through to listing on FIPB agenda and their final disposal and dispatch on official communication is placed on the website, which adds to the transparency of decision making and enhances investor confidence.

3.10. SECRETARIAT FOR INDUSTRIAL ASSISTANCE (SIA)

SIA was set up by the Government of India in the Department of Industrial policy and promotion in the Ministry of Commerce and Industry to provide a single window for entrepreneurial assistance , investor facilitation, receiving and processing all applications which require Government approval, conveying Government decision on application filed , assisting entrepreneurs and investors in setting up projects , (including liaison with other organisations and State Governments) and in monitoring implementation of projects .

3.11 FOREIGN INVESTMENT IMPLEMENTATION AUTHORITY: FIIA

FIIA was established in the department of industrial policy and promotion, ministry of commerce and industry in 1999 to assist the foreign investors in getting necessary approvals and there by facilitating quick translation of FDI approvals into implementation. The FIIA also helps foreign investors in sorting out operational problems and meeting with various government agencies to find solution to problems of the investors.

Fast track committee have been set up in 30 ministries/Departments for regular review of FDI mega projects (wit proposed investment of Rs.100 crore and above), and resolution of any difficulties in consultation with the concerned ministries /state Governments. Unresolved issues are brought before FIIA. FIIA's meetings are held on regional basis as also with investors from specific countries .In the meetings of FIIA, apart from representatives from Ministries from the Ministries of the Government of India, senior officials from State Government also participate.

FIIA frame work has been strengthened recently by adoption of a six point strategy. This includes close interaction with companies at both operational and board room level, follows up with administrative Ministries, State Government and other concerned agencies and sector specific approach in resolving investment- related problems .The major implementation problems are encountered at the state level, as project implementation takes place at the state level.

FIIA has emerged as the effective problem–solving platform for the foreign investors.

3.12 FOREIGN INVESTORS PROMOTION COUNCIL (FIPC) :

Apart from making the policy framework investor friendly and transparent, promotional measures are also taken to attract FDI into the country. Government has constituted FIPC in the Ministry of Commerce and Industry. This comprises professional from industry and commerce .It has been set to have a more target oriented approach towards FDI. The basic function of FIPC is to identify specific sectors and projects within the country that require FDI and target specific regions/countries of the world for its mobilisation.

3.13 INVESTMENT COMMISSION (IC) :

The three-member Investment Commission set up in the Ministry of Finance in December 2004 by the government of India .The Investment Commission (a) advises the Government of India on changes in policy and procedures that will enhance investment in India ,(b)recommends projects and investment proposals that should be fast –tracked/ monitored and (c) promotes India as an investment destination.

3.14. INDIA BRAND EQUITY FOUNDATION (IBEF) :

It is a public – private partnership between the Ministry of Commerce and Industry, Government of India and the Confederation of Indian Industry (CII).It collects, collates and disseminates comprehensive and current information on the Indian economy and business. www.ibef.org has been developed as a single window resource for in-depth information and insight on India. IBEF also produces a wide range of well researched publications focused on India's economic and business advantages.

3.15 REMITTANCE, REPORTING AND VIOLATION :

3.15.1 REMITTANCE AND REPATRIATION

Remittance of sale proceeds/Remittance on winding up/liquidation of companies:

(i) Sale proceeds of shares and securities and their remittance is 'remittance of asset' governed by The Foreign Exchange Management (Remittance of Assets) Regulations 2000 under FEMA.

(ii) AD Category –I bank can allow the remittance of sale proceeds of a security (net of applicable taxes) to the seller of shares resident outside India, provided the security has been held on repatriation basis, the sale of security has been made in accordance with the prescribed guidelines and NOC/tax clearance certificate from the Income Tax Department has been produced.

(iii) Remittance on winding up/liquidation of Companies

AD Category –I banks have been allowed to remit winding up proceeds of companies in India, which are under the liquidation, subject to payment of applicable taxes .Liquidation may be subject to any order issued by the court winding up the company or the official liquidator in case of voluntary winding up under the provision of the companies Act, 1956.AD category-I banks shall allow the remittance provided the applicant submits:

a. No objection or tax clearance certificate from Income Tax department for the remittance.

b. Auditor’s certificate confirming that all liabilities in India have been either fully paid or adequately provided for.

c. Auditors certificate to the effect that the winding up is in accordance with the provisions of the companies Act 1956.

d. In the case of winding up otherwise than by a court ,an authors certificate to the effect that there are no legal proceedings pending in any court in India against the applicant or the company under liquidation and there is no legal impediment in permitting the remittance.

3.15.2 REPATRIATION OF DIVIDEND:

Dividends are freely repatriable without any restrictions (net after Tax deduction at source or Dividend Distribution Tax, if any, as the case may be).The repatriation is governed by the provisions of the Foreign Exchange Management (Current Account Transactions)Rules,2000,as amended from time to time.

3.15.3 REPATRIATION OF INTEREST:

Interest on fully, mandatorily & compulsorily convertible debentures is also freely repatriable without any restriction (net of applicable taxes).The repatriation is governed by the provisions of the Foreign Exchange Management (Current Account Transactions) Rules, 2000, as amended from time to time

3.16 REPORTING OF FDI :

3.16.1 REPORTING OF INFLOW

(i) An Indian company receiving investment from outside India for issuing shares/convertible debentures/ preference shares under the FDI scheme, should report the details of the amount of consideration to the Regional Office concerned of the Reserve Bank not later than 30 days from the date of receipt in the Advance Reporting Form.

(ii) Indian companies are required to report the detail of the receipt of the amount of consideration for issue of shares/convertible debentures, through an AD Category –I bank, together with a copy /ies of the FIRC/s evidencing the receipt of the remittance along with the KYC report on the nonresident investor from the overseas bank remitting the amount. The report will be acknowledged by the Regional Office concerned, which will allot a Unique Identification Number (UIN) for the amount reported.

3.16.2 REPORTING OF ISSUE OF SHARES :

(i) After issue of shares /fully, mandatorily &compulsorily convertible debentures /fully, mandatorily &compulsorily convertible preference shares, the Indian company, has to file Form FC –GPR, not later than 30 days from the date of issue of shares.

(ii) Form FC-GPR has to be duly filled up and signed by Managing Director/Director /Secretary of the company and submitted to the Authorised Dealer of the company, who will forward it to the Reserve Bank.

3.16.3 REPORTING OF TRANSFER OF SHARES :

Reporting of transfer of shares between residents and non residents and vice versa is to be done in form FC-TRS .The form FC-TRS should be submitted to the AD Category –I bank , within 60 days from the date of receipt of the amount of consideration. The onus of submission of the form

FC-TRS within the given time frame would be on the transferor/transferee, resident in India .The AD Category –I bank , would forward the same to its link office .The link office would consolidate the Form FC-TRS and submit a monthly report to the Reserve Bank.

3.16.4 REPORTING OF NON CASH :

Details of issue of shares against conversion of ECB have to be reported to the Regional Office concerned of the RBI.

3.16.5 REPORTING OF FCCB/ADR/GDR ISSUES :

The Indian company issuing ADRs/GDRs has to furnish to the reserve Bank, full details of such issue in the Form enclosed as Annex9, within 30 days from the date of closing of the issue. The company should also furnish a quarterly return in the form enclosed as Annex 10, to the Reserve Bank within 15 days of the close of the calendar quarter. The quarterly return has to be submitted till the entire amount raised through ADR/GDR mechanism is either repatriated to India or utilised abroad as per the extant Reserve Bank guidelines.

3.17 ADHERENCE TO GUIDELINES/ORDERS AND CONSEQUENCES OF VIOLATION

FDI is a capital account transaction and thus any violation of FDI regulations are covered by the penal provisions of the FEMA. Reserve Bank of India administers the FEMA and Directorate of Enforcement under the Ministry of Finance is the authority for the enforcement of FEMA. The Directorate takes up investigation in any contravention of FEMA.

3.17.1 PENALTIES

(i) If a person violated /contravenes any FDI regulations, by way of breach /non adherence /non compliance/contravention of any rule, regulation, notification, press note, press release, circular, direction or order issued in exercise of the powers under FEMA or contravenes any conditions subject to which an authorisation is issued by the government of India/FIPB/Reserve Bank of India he shall, upon adjudication, be liable to a penalty up to thrice the sum involved in such contraventions where such amount is quantifiable or up to two lakh rupees where the amount is not quantifiable.

(ii) Where a person committing a contravention of any provisions of this Act or of any rule, direction or order made there under is a company (company means anybody corporate and includes a firm or other association of individuals as defined in the Companies Act),every person who, at the time the contravention was committed ,was in charge of ,and was responsible to, the company for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

(iii)Any Adjudicating Authority adjudging any contraventions under 6,3.1(i), may , if he thinks fit in addition to any penalty which he may impose for such contravention direct that any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated to the central Government.

3.17.2 ADJUDICATION AND APPEALS

For the purpose of adjudication of any contravention of FEMA, the Ministry of Finance as per the provisions contained in the Foreign Exchange Management (Adjudication Proceedings and Appeal) Rules, 2000 appoints officers of the Central Government as the Adjudicating Authorities for holding an enquiry in the manner prescribed .A reasonable opportunity has to be given to the person alleged to have committed contraventions against whom a complaint has been made for being heard before imposing any penalty.

Under the Foreign Exchange (Compounding Proceedings) Rules 2000, the central government may appoint ‘Compounding Authority ‘an officer either from Enforcement Directorate or Reserve Bank of India for any person contravening any provisions of the FEMA. The compounding Authorities are authorized to compound the amount involved in the contravention to the act made by the person .No contravention shall be compounded unless the amount involved in such contravention is quantifiable. Any second or subsequent contravention committed after the expiry of a period of three years from the date on which the contravention was previously compounded shall be deemed to be a first contravention. The Compounding Authority may call for any information, record or any other documents relevant to the compounding proceedings. The Compounding Authority shall pass an order of compounding after affording an opportunity of being heard to all the concerns as expeditiously as and not later than 180 days from the date of application made to the Compounding Authority. Compounding Authority shall issue order specifying the provisions of the Act or of the rules, direction, requisitions or orders made there under in respect of which contravention has taken place along with details of the alleged contraventions.

After taking into consideration the evolution of FDI policy and ongoing FDI policy of India pertaining to various sectors in detail in the subsequent section we are going to examine the FDI policy of the government related to automotive sector in India.

II

POLICIES OF THE GOVERNMENT PERTAINING TO AUTOMOTIVE INDUSTRY IN INDIA

3.18. INTRODUCTION:

India ranks world's second largest populated country at over 1.21 billion people just behind China. At present less than 1 percent of the population owns automobiles, which is a much smaller proportion than the rest of the South East Asian region. The South East Asia's regional average of ownership is 16.45 percent. The demographic profile of India confers it with the potential of huge market and places it among the fastest growing economies of the world. The evolution of FDI policy in Indian automotive industry could be divided into four phases. The first phase comprise the period from (1947-1965), second phase comprise the period from (1966-1979), the third stage is from (1980 to 1990) the fourth period is the ongoing phase which started from 1991.In the first stage important policies pertaining to automotive industry were framed and implemented. These policies were basically protective, regulatory and oriented towards indigenisation. Although, these policies helped India to build a strong indigenous automotive industry never the less, and these policies did hamper the performance and productivity of the automotive industry in the absence of strong competition from global auto players at that time. The government intervention at subsequent phases during the process of planned economic development in the form of policies did help the economy to pick up growth. One such policy was that of acquisition of foreign technology which was relaxed considerably. The foreign competition inducted into the industry, by relaxation of the foreign exchange and equity regulations, reduction of tariffs on imports and the eventual banking liberalisation that gave impetus to finance driven purchases transformed its dynamics and resultant change which followed is actually, what we all see in the form of the present day automotive industry of India.

3.19 EVOLUTION OF INDIA'S AUTOMOTIVE INDUSTRY :

The first car ran on the street of India in the year 1898, which was brought by a resident of Calcutta (now Kolkata). The next year there were four cars in Bombay (now Mumbai), one of them owned by Jamshedji Tata and the other three also by Parsis. The first pneumatic tyres arrived in Bombay, with Dunlop opening an office in the city. In the year 1901 the first car hit the roads in Madras (now Chennai) In 1903 an American company operated taxi service with a fleet of 50 cars. After the arrival of first car for the next fifty years cars were imported in India Foreign manufacturers had already realised India's potential in this sector of manufacturing because of its huge population base. The number of vehicles imported per year was around 4000 by the end of World War I. It was towards the end of the war that the importance of establishing an indigenous automobile industry was felt in India when Premier Automobiles ltd. (PAL) and Hindustan Motors (HM) set up factories in mid 40s for progressive manufacture rather than assembly from imported components[6]. An eminent Indian engineer and statesman, Sir M.Visvesvaraya, presented a detailed report in 1936 to the then central government regarding formation of an indigenous automotive industry in India[7]. This proposal included the establishment of a factory with a capacity of 11,000 vehicles per year and a capital outlay of Rs 22.5 million. Despite being, pro-growth this was actually turned down by the then government[8]. Never the less this proposal managed to catch the attention of the government started to exploit the growth prospects of this sector and took the decision to invest in it. In 1940s, two Indian industrial houses Birlas and Walchand Hirachand Group, established Hindustan Motors Ltd. (HML) in 1942 and Premier Automobiles Ltd. (PAL) in 1944 respectively. The Indian automotive industry has come a long way in its journey of development. Various socioeconomic and political factors have

[6] See Anjeel

[7] See Ranawat and Tiwari (2009) They made an attempt at identifying policies that have influenced or are influencing the automotive industry's development and at understanding their influences on the same.

[8] See Ranawat and Tiwari (2009) The automotive industry in India was heavily regulated until the 1970s. The automotive firms were obliged to obtain licenses from the Indian government for various firm activities.

shaped the development process of the automotive industry of India. The long term importance of setting up an automotive industry in the country by recognising its place in the planned economy was felt by the National Planning committee which was set up by Indian National Congress [9].After the independence of the country in the year 1947, the government adopted a very strategic approach for the development of Indian automotive industry. Changes in automotive policy framework in India dealing with domestic and foreign direct investment are studied in four phases by taking into account the state intervention that shaped them .Since the domestic automotive policies had a direct bearing on foreign direct investment policies related to this industry occasional mention of domestic automotive policy has also been made. There are four distinct phases in the evolution of automotive industry as of now. Brief account of development of automotive industry in India in these phases is presented in following sub sections:

3.20. PROTECTION, INDIGENISATION AND REGULATION: (1947 TO 1965) :

The government under the leadership of Pt. Jawaharlal Nehru adopted a framework of mixed economy for pacing up the process of economic growth and development. Thus giving out a strong indication of the important role need to be played by both public and private sector. In 1948, Industrial policy resolution (IPR) was passed in the Parliament. This resolution divided the industries of the nation into different categories according to their critical role in enhancing the national income and precisely stated the responsibility of the government in the development of each category of industry. Automotive industry was categorised as the basic industry. All manufacturing units in this category required considerable amount of investment as they were highly skill based (GOI 2008). These industries were also prone of government regulatory system because of the important place they command revenue wise. Although in case of automotive industry the government allowed private enterprises to play a major role. Industrial Development and Regulation Act (IDRA) was

[9]. See Ranawat and Tiwari.(2009)

notified in the year 1951; it acted as a tool for the government to implement its policies. The first automotive policy was formulated in 1949 in accordance with the objectives of IPR, 1948. The tariff on the import of fully built up vehicle was increased in result of import substitute industrialisation. However, the foreign assemblers were allowed to assemble Complete Knocked Down vehicles (CKD). Due to large number of on road vehicles by this time, the ancillary and component industry also began to emerge as potential growth sector along with colossal repair and replacement sector. According to policies of IDRA, an industrial license was required for a unit with 50 or more workers (100 or more without power) to establish a new unit, change the location of an existing one, making a new product, expand output by more than 5% annually or any kind of policy change to conduct a business[10]. In March 1952 the government replaced its 'gut reaction' policy with a more researched oriented approach. The tariff commission in its report to the government in 1953, recommended that only industry with an approach of 'progressive manufacturing' of components and complete vehicles, should be allowed to operate, It also recommended that though the government should avoid direct price control in automotive industry, it should however monitor the prices of different segments/product. Due to this policy foreign assemblers like general Motors and Ford were compelled to close down as they found the domestic demand very low to pursue a policy of 'progressive manufacturing'. The push for indigenisation by imposing a progressive manufacturing programme on the automobile firms was in alignment with the overall goal of self reliance of the government .Minimum 50 % indigenous content requirement was made compulsory by the tariff commission. HML and PAL were already following the above mentioned requirement as they had already established the manufacturing units for some of the components in collaboration with Morris and Fiat respectively. The government in the year 1956 provided special credit and fiscal concessions along with protection rates of tariffs on a number of ancillary items used in the replacement market. The balance of payment crisis in 1956-57 and the prime objective of industrialization in the second

10 . Kathuria 1996, found positive productivity spillover from foreign investors to domestic firms due to policy reforms.

five year plan put a great pressure on foreign exchange reserve. It required immediate policy related reforms on the part of the government. This led to a cut on foreign exchange allocated to automotive industry. As a consequence of this there was reduction of imports of vital components by automotive industry. As a result of this production got curtailed and supply of automobiles decreased. During this time the government decided to impose informal price control mechanism where customer were required to place their order to dealer and deposit a partial payment to the Indian postal service .The vehicles were delivered in sequence of the orders maintained with Postal Department. This helped the government to partially curtail the negative effects of providing protection to the automotive industry. Both small scale units and ancillary units were exempted from licensing requirements under IDRA 1951(GOI 2008b). In 1960 L.K Jha committee was appointed to look into the issues related to the quality and price of automobile industry. This committee recommended the establishment and setting up of indigenous ancillary industry in order to reduce the costs and improve the quality of vehicles. This paved the way for establishment and development of the separate auto component industry of India. In 1965 additional encouragement for small scale sector was provided by reserving 60 to 80 components exclusively for manufacture by small scale units on the recommendation of the L.K. Jha committee. The Indian automotive industry in the years 1947 to 1965 was the one wherein the foreign competition was highly restricted by means of protective rates of tariffs and foreign investment licensing requirements. Foreign collaboration was permitted only after diligent considerations and was subject to effective control by Indian entities. The domestic competition was also controlled by way of industrial licensing, foreign exchange allocations and other governmental decrees. The intentions of protecting and nurturing the nascent automotive industry were accompanied by side effects of high prices and low quality levels. The accomplishment of the industry in terms of consumer choices and the ready availability of vehicles was ineffective and unsatisfactory, however the interest of consumer were safeguarded by informal price control.

3.21 INCREASED REGULATION AND DISPARATE SEGMENTAL GROWTH: (1966 to 1979) :

During the 60s, India waged two major wars, first with China in 1962 and second one with Pakistan in 1965, this put a great pressure on the exchequer further to make things worse, India recorded poor agricultural production due to successive severe droughts, all these led to acute financial pressure in the country. During this time the government led by the then Prime minister, Mrs. India Gandhi altered the automotive policy. The government in May 1966 directed the tariff commission to look into the whole question of continuance of grant of protection to the automotive industry which was received by it until then and also directed to enquire into the cost structure and fair selling price of different types of automobiles[11]. After reviewing the policies the same year, the Tariff Commission recommended the government to continue its support, in order to help automotive industry attain a minimum level of efficiency by limiting the number of models and to impose price controls on passenger cars to make it cost effective . In September 1969, the government imposed price controls on passenger cars. In the same year India's first competition law known as the Monopolies and Restrictive Trade Practice Act (MRTP) was passed in 1969. The MRTP Act classified companies with more than INR 200 million in fixed assets and /or having dominant market share of one fourth or more as MRTP companies. The companies were required to obtain additional clearances (apart from those specified by the IDRA) in order to merge, expand, acquire and relocate. Many automotive firms due to high levels of investment came in the ambit of MRTP commission. The complicated and lengthy process of seeking MRTP procedures and clearances, actually acted as a deterrent for the companies as they had to give public notification of investment plans etc. During this time the policies related to foreign investment and foreign technology collaboration were changed, due to the mounting criticism of the government on account of the greater inflow of foreign capital. In 1968 the government appointed Mudaliar commission to take care of the matters

[11] See Ranawat and Tiwari (2009)

related to foreign collaborations. In the same year Foreign Investment Board was set up to consider the matters related to foreign collaboration and foreign equity participations. The government enacted Foreign Exchange Regulation Act (FERA) in September 1973 in pursuance of its stricter approach by amending the existing laws. This was to ensure prudent use of country's foreign exchange reserves .With this objective the FERA regulated the import of foreign supplies and the functioning of foreign collaborations. FERA created additional constraints on the import of technology, raw material and components for industrial sector in general and automotive sector in particular. The enactment of MRTP and FERA empowered the regulations encompassing the automotive sector. Foreign equity participation was brought down to 40% under FERA. However, government decided the limit in case of those companies which required highly sophisticated technology and professional skill. The policy shift of the government could be seen in the allocation of Fourth five year plan (1969-74) outlay as the government curtailed the outlay to industrial sector. The government gave preference to affordable means of personal and public transport over luxury passenger cars. FERA companies were subjected to greater scrutiny in their functions. The government planned to increase the capacity of commercial vehicles and two/three wheelers during fourth FYP but there was no target to enhance the capacity of the passenger vehicles.

During this phase the automotive industry received another setback in the form of Oil Crisis surfaced in October 1973. The financial concerns of the country compelled the bureaucrats of the Ministry of Finance and the Ministry of industries to take a serious note regarding the functioning of automobile industry. The low fuel efficiency of the Indian automobiles compelled the ministries to take a closer look at the technological development of this industry. The development of non luxury segment of the automobile industry was encouraged to make this industry cost efficient. Accordingly, CVs were added to the Appendix-I list in 1973 which indicated that manufacturers of CVs were to be treated more favourably while taking into account the applications for foreign collaborations and capacity enhancement. In the fifth Five Year Plan (1974

-1979) the government followed the policy of pushing forward the development of 2-wheeler segment to provide mobility to the growing middle class population during that period along with keeping the petroleum consumption at moderate level. Also significant capacities were being licensed for the two wheeler segment. This period saw many new players making their entry to manufacture two wheelers as a result of government policy to promote two wheelers segment. From 1975 onwards; minor relaxations were being made to the licensing regulations. For example 'automatic growth rule' applicable to CVs, ancillaries and tractors since 1975.This permitted an automatic capacity expansion of 5% per year was permitted over and above the 5% automatic growth permitted under IDRA 1951[12]. Non MRTP and non FERA automotive firms producing CVs, tractors, ancillaries and scooters were allowed to expand without any limit. However these companies were barred to manufacture products reserved for the small scale sector. The import of raw materials and machinery required for undertaking expansion of plant needed additional clearances. In 1978 the government dismantled some of its stricter controls on foreign exchange equity collaborations. Thus, in this phase the Indian Automotive industry witnessed some tough regulations with the enactment of MRTP and FERA. The macroeconomic instability and tough policies of the government adversely affected the average annual growth rate of passenger car segment, which was around 2.8% over the entire period 1966 to 1979 .With the assistance of the Ministry of Industry, the automotive industry established the Automotive Research Association India in 1966 for promoting R&D efforts within the industry.

3.22 LIMITED LIBERALISATION AND FOREIGN COLLABORATIONS (1980-1990) :

This period is better remembered as the re election of Mrs. Indira Gandhi as the eighth Prime -Minister of India in January 1980 .The new government had to face the resentment of the people, about its regulatory policies related to the industrial sector. The poor performance of Indian

[12]. See Ranawat and Tiwari (2009)

industries aggravated by the demand problems arising out of unexpected oil shocks of the 1970s had created a lot of outrage. The government considered it necessary to review its existing policies and implement measures to make the industry more competitive. The restrictive rules and licensing controls were eased .The most important step in this direction was to allow the import of latest technology required for modernisation. In July 1980 the government presented its new industrial policy statement highlighting the policy shift. Various relaxations were made to the regulations related to capacity expansion, technology up gradation, licensing and foreign collaborations. Imports of raw material/components required for the modernisation were also treated more liberally. The government continued with its encouragement for the development of C.V segment in this phase. In 1981 the government gave letter of intent to four Indian firms for the manufacture of LCVs. These firms were in technical and financial collaboration with Japanese firms and were licensed a production capacity of 12,500 vehicles per year[13]. The passenger car segment also witnessed a major change during this phase. In its policy of 1980 the government intended to favour consumers by providing them with wider range of choice regarding all types of cars including luxury cars. Accordingly, the passenger car segment was added to the Appendix I list in 1982 along with UVs and 2 /3 wheelers; previously (in 1970s) it was classified as a luxury car. In 1982 state owned Maruti Udyog limited (MUL) formed collaboration with Suzuki of Japan, as the government decided to actively participate in the passenger car segment in order to improve its competitiveness. In 1984 the first car rolled out of MULs factory. This was heralded as the beginning of a new era. Fiscal incentives were given to the car manufacturers in 1984 so that they can import latest fuel efficient technology for use in indigenous models. Many domestic players took advantage of the situation and upgrade their technology either by importing or by allowing foreign equity participation.

[13] See Pingle1999.

M & M which had a monopoly in the UV segment had to upgrade its model by collaborating with Peugeot (France) in the changing scenario under the competition from MUL's UV model. Many of the two wheeler manufacturing companies like Bajaj Auto, TVS motors and Escorts entered into technology collaboration with Kawasaki, Suzuki and Yamaha respectively under the changing scenario to upgrade their model.

Thus in early 1980s, the entire framework of Indian Automotive Industry changed with the entry of foreign players and pro-industry policy of the government in the form of import relaxations and fiscal incentives. Indian consumer now got to choose from an array of fuel efficient better models provided by different manufacturers. The automatic growth and capacity control policy of 1970s were continued, in order to keep the prices of vehicles affordable and economical. With the inclusion of all automotive segments to Appendix –I list by 1982; the automatic growth rule became accessible.

However, in 1984 all automotive segments were brought under 'Schedule IV', this meant all the firms of the industry were now put under special regulation in order to operate, due to the apprehensions of environmental pollution, shortage of raw materials etc[14]. With the implementation of this policy, all the benefits which were granted till then were nullified. There was a ban for rest of the phase on the entry on new foreign players and also on any technology collaboration[15]. In January 1985 the government headed by Prime Minister Rajiv Gandhi as the ninth Prime Minister of India, brought some hope for the automotive industry .It announced a policy of 'broad –banding' enveloping the entire industrial sector, the manufacturers were allowed to use the installed capacity. Under this scheme more space was created for extensive products i.e. licenses were issued for the production of broader product groups as opposed to the

[14] See Kathuria 1996. Found that the changes in policy atmosphere indeed shifted the technology trajectory of the automobile industry through competitive pressure.

[15] See D'Costa 1995; Kathuria, 1996; Narayan, 1998 they found policy measures could not maintain a balance between the degree of indigenization and technology development. Industry experienced stagnancy on technology front.

single product licenses done previously. Thus this scheme enlarged the ambit of production by providing the manufacturers with freedom to select the right product mix to be produced and thereby make optimal use of their capital investments. Under this scheme passengers cars, CVs and UVs were put into one product group named ‘on road four wheelers’. This entitled the firms operational in the above mentioned segments to diversify their product according to their capacity and the prevailing demand conditions. Similarly all two wheelers up to 350 cc engine capacity were bunched together under this scheme; this was further expanded to include three wheelers and automobile ancillaries in 1986. According to a new policy , in 1985, all automobile component manufacturers were exempted from sections 21and 22 of the MRTP act, which meant that the large industrial houses were no longer required to take MRTP approvals and government implementing economies of scale scheme by promised to actively encourage firms to achieve optimum utilisation of installed capacity. The governments call for indigenisation of the technology continued in this phase, where all JVs (vehicle and component) were directed to achieve 95 % indigenisation under the phased manufacturing programme.

The entry of large number of foreign players as a result of JVs and due to a wide range different models and designs of vehicles made it necessary on the part of domestic component manufacturers to advance technologically. Thus the auto component sector also witnessed substantial changes.

Motor Vehicles Act passed in 1988 required, Indian vehicles to be certified under the standard laid by Bureau of Indian standard.

By the end of this phase the limited de-regulation drive for industrial production came to a halt due to the growing opposition from within the ruling party. However the limited liberalisation that took place during this phase had a huge impact on the development of India’s automotive industry in the years to come.

3.23 LIBERALISATION AND GLOBALISATION: 1991 ONWARDS

The structural reforms were implemented by the government in 1991, to handle economic crisis as a result of acute balance of payment situation during 1990-91, popularly known as liberalisation and globalisation. The government applied some radical changes in its policies related to trade, foreign investment, exchange rate, industry, fiscal affairs and so on in the mid 1991.

The emphasis was towards creating a more competitive environment and removing the barriers to entry and growth of foreign firms.

Some important policy decisions made by the government in this regard were as follows:

(i) Except for a few critical industries related to security concerns licensing system for all other industries was abolished.

(ii) Automatic approval of FDI up to 51 % equity in high priority and strategic industries.

(iii) Imports of capital goods auto clearance was granted with the condition that the foreign exchange required is available through foreign equity.

(iv) In high priority industries automatic permission was granted for foreign technology agreements with the condition that prescribed royalty rates or a lump sum payment not exceeding INR 10 million.

(v) The threshold limit of assets for MRTP companies and large dominant undertakings was removed by amending the MRTP Act,

(vi) Progressive disinvestment in those public sector enterprises where the performance is not satisfactory by reviewing of the existing portfolio with greater realism and where private sector had developed sufficient expertise and resources.

In 1991, Mass Emission norms were introduced for petrol vehicles and in 1992 for Diesel vehicles. In 1997 National High way Policy was announced which had a positive impact on the automotive industry.

In July 1991 the vehicle segments (except passenger cars) and the auto component segments were delicensed. The passenger car segment was delicensed in May 1993.The MRTP clearance was terminated which meant that now the automotive firms were free to enter, expand, diversify, merge or acquire. Several global players entered into Indian market, during this phase by establishing joint venture (JVs) with domestic players. FDI up to 51 % was allowed on an automatic basis, above 51% required governmental clearances which were approved on a case to case basis depending on the projected exports, sophistication of technology brought in, etc. The phased manufacturing programme requiring time bound indigenisation was dropped in 1991 for the new units and in 1994 for the existing units.

Though the long term measures of the government under structural reforms 1991 benefitted the automotive industry. The short term measures adversely affected the growth rate of automotive industry. For example the government discouraged the consumption of petroleum by imposing a surcharge of 25% on petroleum products. Heavy excise duty imposed by the government on selling price of all automobiles acted as deterrent for the growth of this sector. Auto policy 2002 allowed automatic approval of foreign equity investment up to 100% for the manufacture of automobiles and auto components

The Auto policies 2002 have been continued to apply till date with minor modifications. The government rationalised its tax structure along with reductions in the overall tariff rates to open up India for international trade. The environmental and safety norms were also adhered by introducing Euro I, Euro II and Euro III in the year 1996, 2000 and 2005 respectively. With its accession to United Nations Working Party-29 in 2005 India has been making efforts for harmonisation of auto standards worldwide and integrating its auto industry into global automotive industry.

Thus this phase was increasingly investor friendly, the liberal trade measures adopted by the government led to momentous increase in the number of foreign players. The domestic players were also encouraged to undertake entrepreneurial endeavours. Strong macroeconomic base of demand growth drivers along with convenient credit facilities ensured rising demand for vehicles in the country. The bold measures taken by the government along with its continued support to the automotive industry had put the Indian automotive industry on a fast track of development.

Some of the key policy changes that transformed the entire structure of the automotive industry are discussed below:

3.24 LIBERALISATION OF THE AUTOMOTIVE POLICY:

The major elements of automotive policy were: Delicensing, relaxation for important components imports, 51% FDI through automatic route, giving away the local content requirements. The above mentioned policy decisions started showing their impact on the development of automotive industry by 1995. The existing firms operating at that time changed their operations in response to these policy changes. The presence of foreign player led to fierce competition in the domestic market. Most of the existing firms either started developing their own technology or were compelled to import foreign technology, through imports, licensing or joint ventures. During this phase the country saw the entry of many foreign auto players in the economy due to delicensing and 51% entry through automatic route. The auto technology transfer and acquisition thereafter adaptation from foreign to domestic firms was better in the liberalised phase due to rising of the equity cap which was limited to 40% in joint venture system earlier.

During this phase an attractive policy for new foreign entrants who were allowed to assemble their SKD and CKD kits was giving up of 'the phased manufacturing programme' which required 95% of indigenisation by the automotive firms. However from 1997 onwards the new foreign auto manufacturers were required to sign MoU with DGFT (Director General of Foreign Trade) for importing SKD/CKD kits which made export commitments mandatory along with indigenous or domestic production.

The foreign players were also compelled to maintain foreign exchange neutrality. The above obligations compelled the foreign firms to venture into Indian automotive industry for the purpose of manufacturing for export by basing the production on factor market (UNCTAD2003).

Notwithstanding the above obligations, liberalisation and the entry of foreign auto manufacturers made the quality of automotive production in India technologically superior, as the international players brought with them world class technology, which was reflected in design and engine of automobiles and their manufacturing practices which spell quality.

The Auto Policy 2002 aimed to establish a globally competitive automotive industry in India. This policy chalked out the direction of growth for the automotive industry. This also emphasized to promote R&D there in order to ensure continuous technology up gradation as well as building up of better designing capacities. It laid stress on low emission fuel auto technologies and availability of appropriate auto fuels, alternate fuels in order to take auto manufacturing to a self fostering level.

3.25 CONCLUSION:

The sweeping changes introduced since 1991 till date mark a radical departure from the past and reflect a positive approach towards foreign capital. All these ongoing policy changes provide a freedom to foreign investors to enter into Indian industry. Under the present liberalisation policy India’s restrictions on the foreign equity ownership are above the average of the countries covered by the investing across sectors indicators in the South Asia region of the BRIC countries. FDI is given automatic approval up to 100 p.c. for manufacturing activities including software development, hotel and tourism. Besides there is no upper bound for foreign equity, even 100 % equity is permitted with prior approval. Permission is given freely to 100% foreign equity in the power sector, wholly exports oriented industries, all manufacturing activities in Special Economic Zone in the telecommunication sector for Internet Service

Providers, infrastructure providers and electronic mail and voice mail. The government has adopted a liberal approach towards non resident Indians (NRIs) investment. NRIs and OCBs can invest up to 100% in real estate sector and in certain high sector industries. In the context of comparison of Indian FDI policy with that of other East Asian countries we find that in China foreign ownership is decided on case by case basis with 100% foreign ownership permitted in export oriented and high technology industries .In Malaysia foreign ownership is permitted in exports oriented and high technology industries .In Indonesia, minimum 20 % local participation is insisted upon in all foreign investments with local equity holding being increased to 51%.In Thailand , foreign majority participation is prohibited in category ‘A’ industries (for e.g. rice farming, professional services) and restricted in category ‘B’ (for e.g. pharmaceutical products, trade, hotels, etc.)In category ‘C’ including all manufacturing activities foreign direct investment including foreign majority equity can enter even without permit. In South Korea there is no restriction in foreign equity participation with prior approval. In a large number of Asian countries foreign majority ownership is permitted in manufacturing activities but in service sector foreign ownership is limited to minority. Thus in comparison to her major competitors like China and Malaysia, Indian policy is considered better to the extent that in a large number of manufacturing industries foreign majority ownership is freely allowed without any restriction. Although it remains restrictive in comparison with a majority of OECD countries as shown by the OECD’s FDI Restrictiveness Index. Many of the current FDI restriction in place apply to relatively low productivity sectors where growth could be accelerated by the enhanced productivity that would benefit from increased foreign investment. For example banking, insurance and especially retail distribution, where the influx of FDI could help raise incomes in the agricultural sector while increasing choice and lowering living costs for consumers.

In India, all cases other than those coming under the parameters of automatic approvals require prior scrutiny and clearance of the government, Foreign Investment Promotion Board or the Secretariat for Industrial Approval clears such proposals. The fact need to be appreciated that in India the approval requirements are lower in number and less rigid.

Thus in a nut shell it can be said that the changes since 1991 mark a radical departure from the past and reflect a positive approach towards foreign investment and collaboration. India has made tremendous progress in building a policy environment to encourage investment. As a result, the country's economy is growing more rapidly and FDI inflows have accelerated impressively. However, since the last couple of years investment remains insufficient to meet India's needs, particularly in infrastructure .Current efforts to strengthen and liberalise the regulatory framework for investment need to be intensified and implemented at an accelerated pace at national level , across the states and union territories. In the next chapter impacts of FDI inflows on the economic growth of India has been examined to gaze the efficacy of the FDI related policies.