

Update

Group companies defined under FDI norms to remove ambiguities

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June 4, 2013



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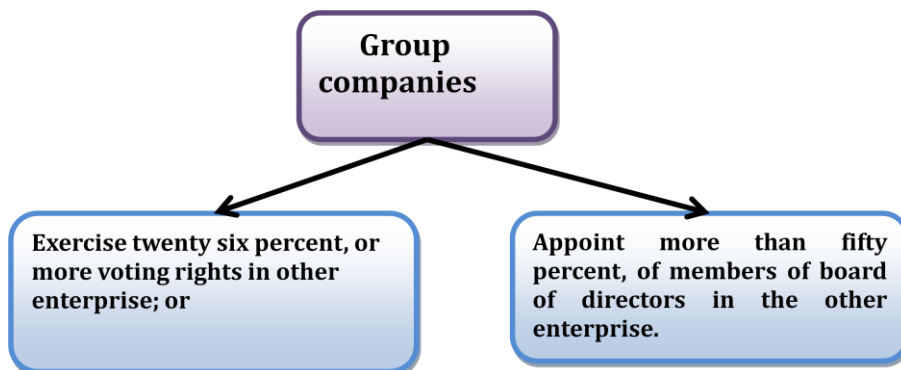


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Introduction

In a move to end all ambiguities in the implementation of rules that prevent cash and carry companies from indirectly engaging in front end retail through associate firms, the Department of Industrial Policy and Promotion (“DIPP”) issued a Press Note No. 2(2013 series) (“Note”)¹ on June 3, 2013, which has been brought into effective from June 5, 2013. The said note defined “Group Companies” under Foreign Direct Investment norms for the purpose of bringing greater clarity in transactions which take place among group companies. According to the Note, the group company shall mean two or more enterprises which, directly or indirectly, are in position to:

- (a) Exercise 20% or more voting rights in the other enterprise; or
- (b) Appoint more than 50% of members on board of directors in the other enterprise.



Background

It is the intent and objective of the Government of India to attract and promote FDI in order to supplement domestic capital, technology and skills, for accelerated economic growth. Also, FDI has the connotation of establishing a lasting interest in an enterprise that is resident in an economy other than that of the investor.

In the year 2010, while 100% FDI is allowed in cash & carry wholesale trade, restriction has been imposed on sale by such a foreign investment funded venture to its group company from selling more than 25% of goods to its group companies. This stipulation was brought to preclude indirect entry of foreigners in multi brand retail, although in the previous year FDI was opened up to 51%. Confusions arose as to the meaning of group companies as the DIPP then, did not define its meaning. It was also unclear if FDI ventures were flouting rules. Group company, for that matter was defined under various laws and as such differences began cropping up regarding which definition should be adopted.

¹ See the press note here : http://dipp.nic.in/English/acts_rules/Press_Notes/pn2_2013.pdf



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It was initially deliberated and expected to defined 'group company' in line with AS 23², wherein group company has been construed to mean:

“A group is a parent and all its subsidiaries”

However, for easier and better assessment, considering the aforesaid definition under AS 23 is very broad and does not set out proper limits, it was decided against following the said definition. Ultimately, definition as per foreign trade policy was adopted because DIPP wanted a liberal definition covering only wholly owned subsidiaries whereas the Finance Ministry favoured a more stringent one given by the RBI that included affiliate entries with more than 20% interest. After heavy deliberations, both zeroed in on definition provided under the foreign trade policy.

Before the Note clarified the definition and ambit of a group company, close scrutiny of the corporate structure helped identify about a group company status.

It has been stated that the definition of group company will have a key to the future operations of wholesale firms.

Conclusion

What came as a relief to promote foreign trading was sought for a long time. The retail companies with foreign joint ventures have now reasons to be happy. It is expected to bring certainty in the manner where anyone can take a position depending upon the given definition but it does not make things easier for foreign investors. Vide the Note; the government has taken a positive initiative by removing bottlenecks in FDI. Further, the clarity in rules will bring in much sought after transparency and better assessment in how group companies are assessed and operate with regard to foreign policy directives. While existing structures of enterprises have to be studied to establish if they are related and subject to restrictions incorporated in the FDI policy, a clear definition of group companies will ensure that the same rules will apply for all. This move was clearly meant to plug a hole that was being exploited by retailers when it came to sourcing from Indian Companies. It is expected that this move shall prompt wholesale cash and carry players and help them to diversify their vendor base in the company.

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² See here : http://www.icai.org/resource_file/267accounting_standards_as23new.pdf