Analytical Speaking

Cabinet Announcements on FDI followed by DIPP notifications: Looking forward to foreign investment in Retail, Power, Aviation and Broadcasting Sectors

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Date: September 21st, 2012

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With the vision of reducing geographical boundaries and forming a global platform for the international as well as domestic investors in the field of MULTI BRAND RETAIL, AVIATION, POWER TRADING & BROADCASTING, the Union Cabinet on 14th September 2012 announced remarkable reforms which was followed with very quick notifications by Department of Industrial Policy and Promotion (DIPP) despite of all the political pressure built around by the opposition parties. The DIPP notified the Cabinet decisions on liberalising FDI norms in single-brand retail, multi-brand retail and the aviation sector, as well as changes announced for investment in broadcasting and power exchanges on 20th September, 2012.

FDI in Multi-brand retail

With a convivial note to the famous retail brands like Walmart, Carrefour & IKEA, they can now set up shop with a local partner and sell goods directly to consumers. In fact, Walmart Stores Inc is looking to open its first retail outlets in India within 12 to 18 months. The Cabinet has now approved FDI in multi brand retail trade up to 51%, with Government approval. This is a significant step taken by the Government to bolster economic growth. The proposal to allow FDI in multi brand retail trading was 1st laid down in July 2010, when DIPP first introduced its discussion paper[1] on allowing FDI in multi-brand retail. The proposal was then approved by the Cabinet in November 2011. But, because of the political criticism, the proposal was kept on hold, till the last Friday i.e. 14th September, 2012, on which date it was finally approved by the Cabinet subject to several conditions laid down below[2]. Further, the same was notified by DIPP on 20th September, 2012 vide Press Note No. 5 (2012 Series)[3].

Conditions for FDI in Multi-brand retail:

- Retail outlets in States which have agreed or will agree to allow FDI in multi-brand retail subject to applicable local State laws;
- Retail outlets only in cities with a population of more than 1 million people as per the 2011. For States without cities meeting the Population Threshold, retail outlets may be set up in cities of their choice (preferably the largest city). In either case, retails outlets can also be set up to cover an area of 10 kms around the municipal / urban agglomeration limits of such cities.
- Minimum amount to be brought in, as FDI, by the foreign investor, would be US$ 100 million.

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[1] http://dipp.gov.in/English/Discuss_paper/DP_FDI_Multi-BrandRetailTrading_06July2010.pdf

[2] http://pib.nic.in/newsite/erelease.aspx?relid=87768

[3] http://dipp.nic.in/English/acts_rules/Press_Notes/pn5_2012.pdf

- At least 50% of the total FDI must be invested in back-end infrastructure within 3 years of investment. Back-end infrastructure includes processing, manufacturing, distribution, etc. but does not include land cost and rentals.
- 30% of the procurement of manufactured/ processed products shall be sourced from small industries / village and cottage industries, artisans and craftsmen.

The detailed notification is available in the press note 5 mentioned above.

Our analysis:

The Power in the hand of State Government is given that it would be the prerogative of the State Governments to decide whether and where a multi-brand retailer, with FDI, is permitted to establish its sales outlets within the State. Further, the restriction of establishment of retail sales outlets in cities with a minimum prescribed population would limit reach of foreign investor. This is reasonably justified given the fact that the unorganized retail in small cities would not be able to compete with the large companies. The minimum capital investment of US$ 100 million is justified given the amount of seriousness required in the retail industry. Also, the requirement of 50% investment in back-end infrastructure will help in improving the supply chain management and would also enable the poor farmers to obtain a remunerative price for their produce. Further, the condition for 30% procurement from small industries is similar to the requirement of single brand trading which is discussed below.

To allow FDI of 51% in retail sector isn't just a mere decision for the development of India; Fore sighting the fact that there is an immense un-employment problem prevailing in our country, this initiative would help in creating an additional 10 million job opportunities for the citizens.

100% FDI in single-brand retail

Vide Press Note 1 of 2012; the Government had raised the investment limit for single brand retail from 51% to 100% subject to various conditions. The two conditions that created obstacle in investment by foreign investors are that the foreign investor should own the brand and for FDI beyond 51%, sourcing of 30% of the value of the goods sold by the Indian company must be from small industries / village and cottage industries, artisans and craftsmen.

To address these concerns, the Cabinet has now decided to modify those conditions. The 1st condition is replaced as follows:

- One non-resident entity, whether owner of the brand or otherwise, to undertake single brand retailing in India for that specific brand by executing a legally

tenable agreement with the brand owner. The onus for ensuring compliance with this condition is with the Indian investee company and a copy of the brand license or other agreement must be submitted by the investing company to the Government.

The 2nd condition is replaced as follows:

- The quantum of domestic sourcing will be self certified by the Indian investee company and verified by its statutory auditors.

This has made the conditions preferable, as the Indian Investee can select the sectors where such sourcing is feasible. However, it is still unclear how this condition will be enforced. Further, the term "value of the goods sold" still needs to be define or clarified. Pending this requisite clarification, the DIPP notified the amendments vide Press Note No. 4 (2012 Series)[4] dated 20th September, 2012.

FDI in Power Trading

With the recent buzz on the coal prices increasing rapidly due to some unaccepted and false ways, allowing 49% (FDI limit of 26 per cent and FII limit of 23 per cent of the paid-up capital) in power trading sector seems to be a sign of relief for the Power trading companies. This has to be done in compliance with SEBI Regulations; Central Electricity Regulatory Commission (Power Market) Regulations, 2010; and other applicable laws/ regulations; security and other conditionalities. Further, the FDI is permitted under the approval route whereas FII investment is permitted under the automatic route. This is expected to strengthen the power trading exchanges, enhance the availability of power and improve its distribution for inclusive development. The detailed DIPP notification is available in the Press Note No. 8 (2012 Series)[5] dated 20th September, 2012.

Benefits:

Having known the fact that the Indian market is very attractive in abroad as far as investing here is concerned, this step would help us to attract more potential investors.

FDI in Airlines

The recent structure of the aviation industry is that the Indian movers are not able to maintain the standard level which has created a bad image. Moreover the shutdown of the Kingfisher Airline has also widely affected the Indian aviation sector. Keeping this in mind it was a need of hour to involve investment from foreign entities. Having said this,

[4] http://dipp.nic.in/English/acts_rules/Press_Notes/pn4_2012.pdf
[5] http://dipp.nic.in/English/acts_rules/Press_Notes/pn8_2012.pdf

the cap of 49% FDI in airlines seems to have given an added advantage to investors abroad.

Conditions for FDI in Aviation:

- The investee company must have its principal place of business within India;
- The Chairman of the Investee Company and at least two-thirds of its directors must be Indian citizens;
- The substantial ownership and effective control of the investee company must lie with Indian nationals;
- All foreign nationals likely to be associated with the investee company must be approved by the Government from a security standpoint;
- Technical equipment that might be imported into India must be approved by the relevant authority of the Ministry of Civil Aviation.

The detailed DIPP notification is available in the Press Note No. 6 (2012 Series)[6] dated 20th September, 2012.

Benefits

As said earlier, the kind of global service provided by the Indian players at the international front is not up to the mark. Having 49% investment in this Sector will change the scenario and help in implementing global service standards and practices. Further, the reduction in ever increasing Air fare can be expected.

Foreign direct investment in broadcasting

The Cabinet Committee on Economic Affairs has approved the proposal of the DIPP for Review of the policy on Foreign Investment (FI) in companies operating in the Broadcasting Sector vide a press release issued on September 14, 2012[7] through which the limit of foreign investment in companies operating in the broadcasting sector was raised from 49% to 74%. The same is notified by DIPP vide Press Note No. 7 (2012 Series)[8] dated 20th September, 2012. This would enhance the access to foreign investment and would in turn enable the expansion of the reach of broadcasting services. The approved policy for investment in broadcasting sector is now consistent with that of the telecom sector.

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[6] http://dipp.nic.in/English/acts_rules/Press_Notes/pn6_2012.pdf
[7] http://pib.nic.in/newsite/erelease.aspx?relid=87787
[8] http://dipp.nic.in/English/acts_rules/Press_Notes/pn7_2012.pdf

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Every coin has two sides, likewise with regards to this decision of the Cabinet, few set of people have their own verdict, which is against these changes.

With respect to FDI in retail sector it is noticed that the traditional Indian farmers would be in a jack. It would lead to unfair competition and ultimately result in large-scale exit of domestic retailers, especially the small family managed outlets, leading to large scale displacement of persons employed in the retail sector. Another concern is that the Indian retail sector, particularly organized retail, is still under-developed and is in a nascent stage and that, therefore, it is important that the domestic retail sector is allowed to grow and consolidate first, before opening this sector to foreign investors.

Further there are certain inherent uncertainties and disadvantages in the FDI in the aviation sector of India, to both foreign companies and investors and the Indian aviation companies and investors in the short and long terms. The business competition in the Indian aviation market will be more and intense, and will favor the big players. The presence of greater number of aviation companies will reduce the overall profitability. Cost of employment for highly qualified and talented aviation professionals will rise regularly.

Concluding remarks:

The decisions of the Union Cabinet if implemented in a much firm and positive way, we can definitely see India's progress graph moving upwards.