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Foreign Investment: The Road Ahead

A change in policy

Under the provisions of a Government of India notification (Press Note 18), which came into effect on December 14 1998, foreign companies which previously or currently have joint ventures, technology collaborations or trademark license agreements in India are prohibited from "automatically" making new foreign direct investment in India in the "same or allied field". All such foreign investors must apply for approval of new investment to the Foreign Investment Promotion Board (FIPB). Procedurally, the FIPB requires that each application be accompanied by a "no-objection letter" from the prior or existing Indian joint venture partner, technology collaborator or trademark licensee.

The government's objective in issuing Press Note 18 was to protect the interests of local shareholders, promoters and Indian financial institutions, and prevent a dominant foreign investor from abandoning existing joint ventures. In practice, however, it has been frequently used as leverage over foreign investors, and Indian parties have refused to supply a no-objection letter on the thinnest of grounds. This has created significant delays in getting much needed new foreign investment in certain sectors of the Indian economy. In a few cases, it has also led to litigation and deadlock between foreign and Indian investors, with a consequent erosion in the value of the business.

However, while Press Note 18 still stands, a decision by the Indian government on a case that occurred in the second quarter of 2003 indicates that it may be softening its stance on foreign investment policy. In the case, a US company completed a global acquisition of a company that had a second-tier publicly listed subsidiary in India. Pursuant to India's securities laws, the US company was required to make an open offer for the public shares of the Indian company before it could exercise any control over its newly acquired Indian subsidiary. However, the US company had an existing joint venture in India and was therefore also required to get FIPB approval. The US company duly applied to the FIPB, but its Indian joint venture partner refused to grant the no-objection letter. After months of debate and indecision, the government made history by approving the new investment without first receiving the no-objection letter and despite the Indian joint venture partner's strong objections.

From the government's perspective, the exception was justified on the grounds of protecting the minority shareholders and public investors of the target company. The open offer could not have been completed without the investment approval, and thousands of small investors who had tendered their shares would have been the losers. Irrespective of the rationale, this may be an early sign of welcome change.

More recently, the Indian government permitted a Saudi Arabian company to supply new technology to a new Indian partner despite the objections raised by its existing Indian collaborator. The Indian collaborator is now suing the government. At issue is whether the government can itself deviate from its foreign investment policies. Foreign investors are keenly awaiting the judicial outcome.

Although the government's public statements on Press Note 18 have been few, there appears to be a general desire to withdraw it. Indian businesses are opposing this and with general elections expected in the next six to nine months, a quick decision on this controversial topic is unlikely.

Satellite uplinking guidelines changed

On August 22 2003, the Indian government announced a change in foreign equity guidelines for satellite news channels uplinking from India. At present, news channels are permitted to have foreign equity investment of up to 26%. Now, they will also have to ensure that the 51% Indian equity is owned by a "dominant" Indian partner, i.e., one who has the financial strength to hold 74% equity. In addition, operational control of the editorial content is required to be in Indian hands. Other adequate capitalization requirements have also been announced. This change was triggered by the government's experience with the first uplinking application made by the Rupert Murdoch – controlled Star News, which the government felt met the letter but not the spirit of Indian policy. Star News has a month to comply with the new guidelines. Similar tighter guidelines are expected for foreign investment in the print media.

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