Luthra and Luthra
LAW OFFICES INDIA

# FOREIGN DIRECT INVESTMENT

**Presented by**
**Harish Kumar**
**Partner, Luthra and Luthra Law Offices India**
**September 1, 2023**

# Downstream Investment - Overview

Downstream Investment means *"an* *investment made by an Indian Entity* *which has total foreign investment in it, or an Investment Vehicle* *in the capital instruments or the capital, as the case may be, of another Indian entity*."

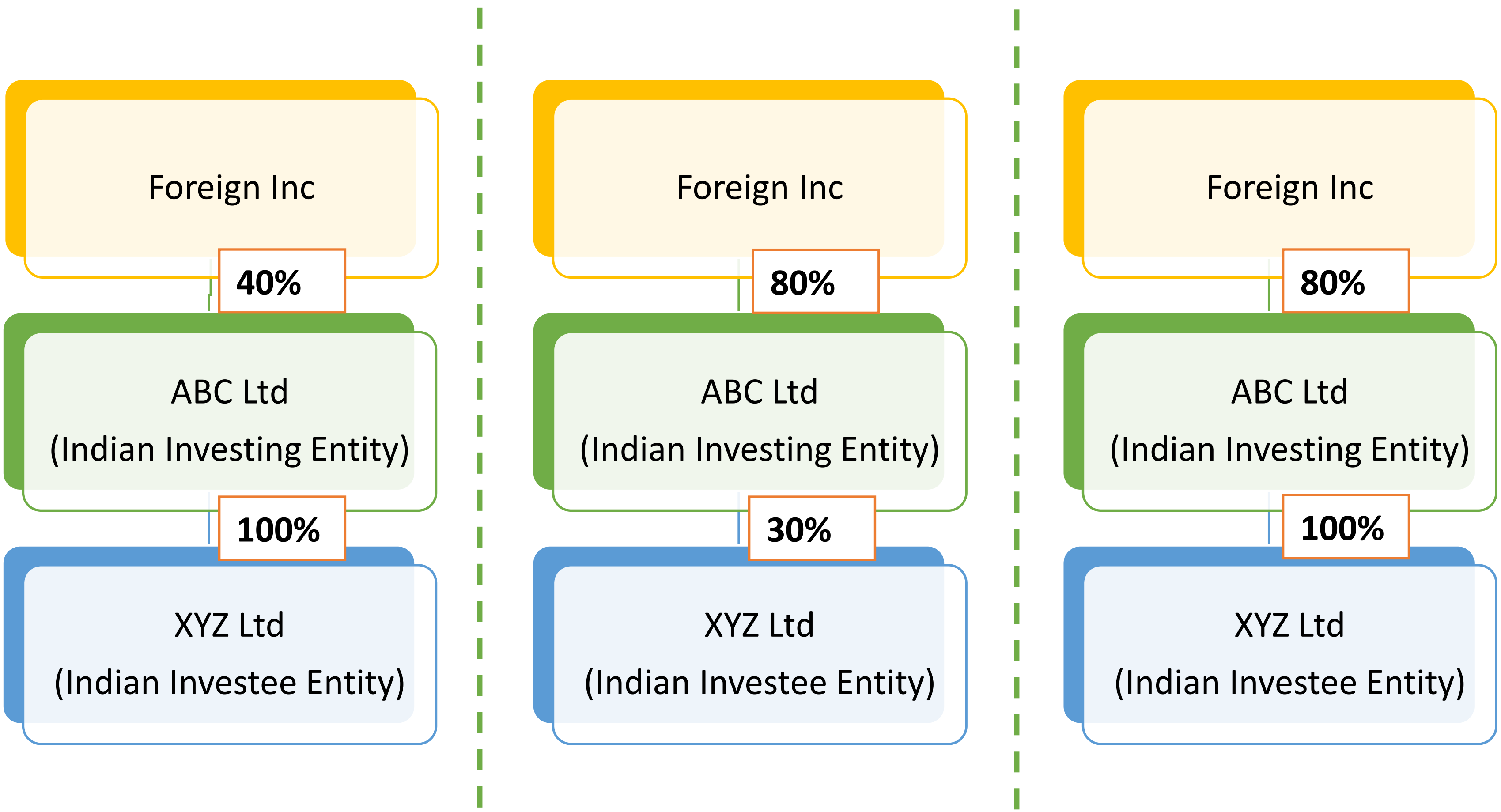
**Indirect foreign investment means DI received by an Indian entity from**

- another Indian entity which has received foreign investment
  - not owned + not controlled by PRI or owned or controlled by PROI
- investment vehicle whose sponsor / manager
  - not owned + not controlled by PRI or owned or controlled by PROI

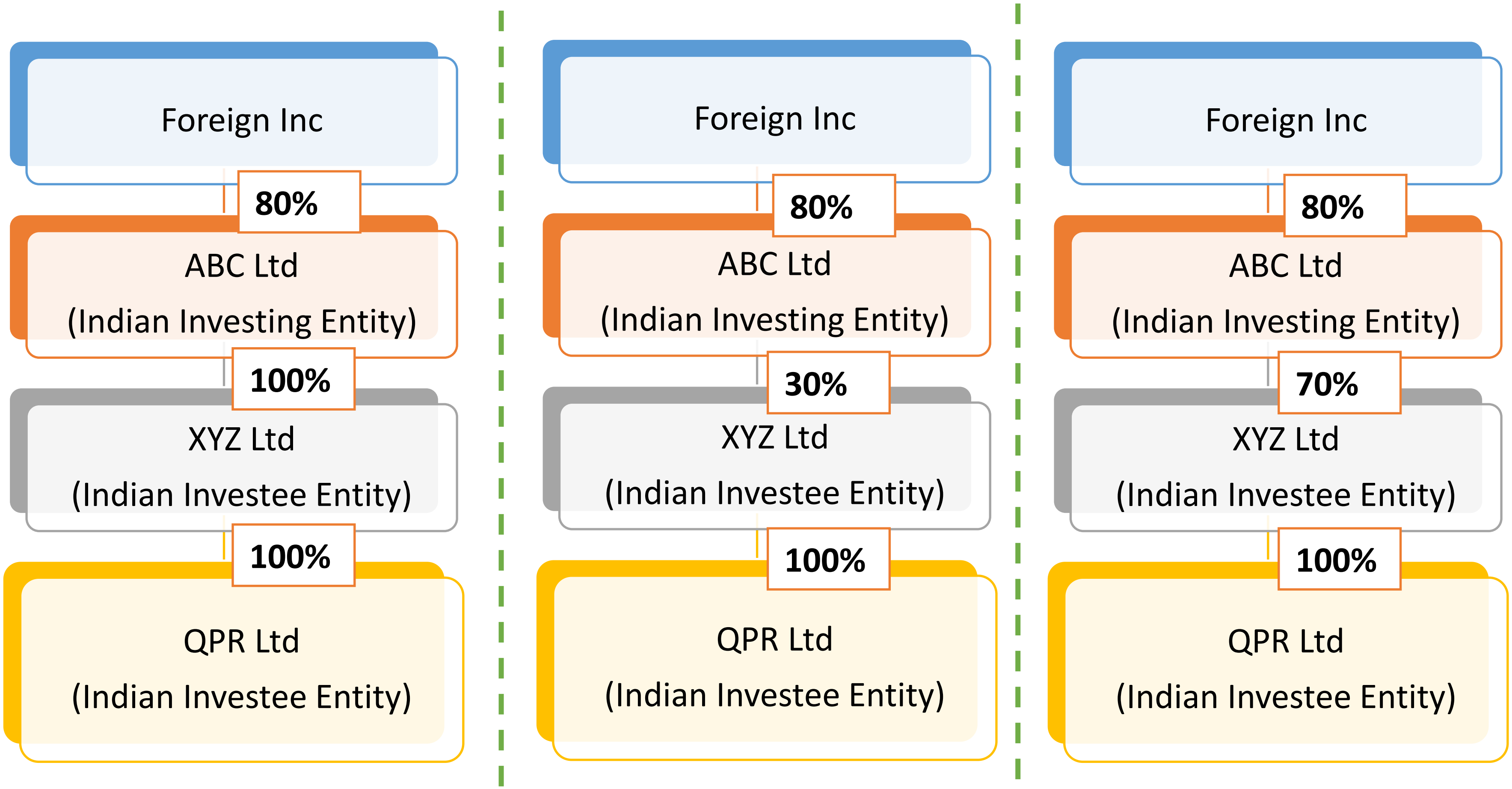
**Basic concepts**

- **Total foreign investment** = foreign investment + indirect foreign investment
- **Ownership of an Indian company**: beneficial holding > 50% of equity instruments
- **FOCC**: Foreign owned and/ or controlled company
- DI is when an Indian Entity (FOCC) makes investment into another Indian Entity

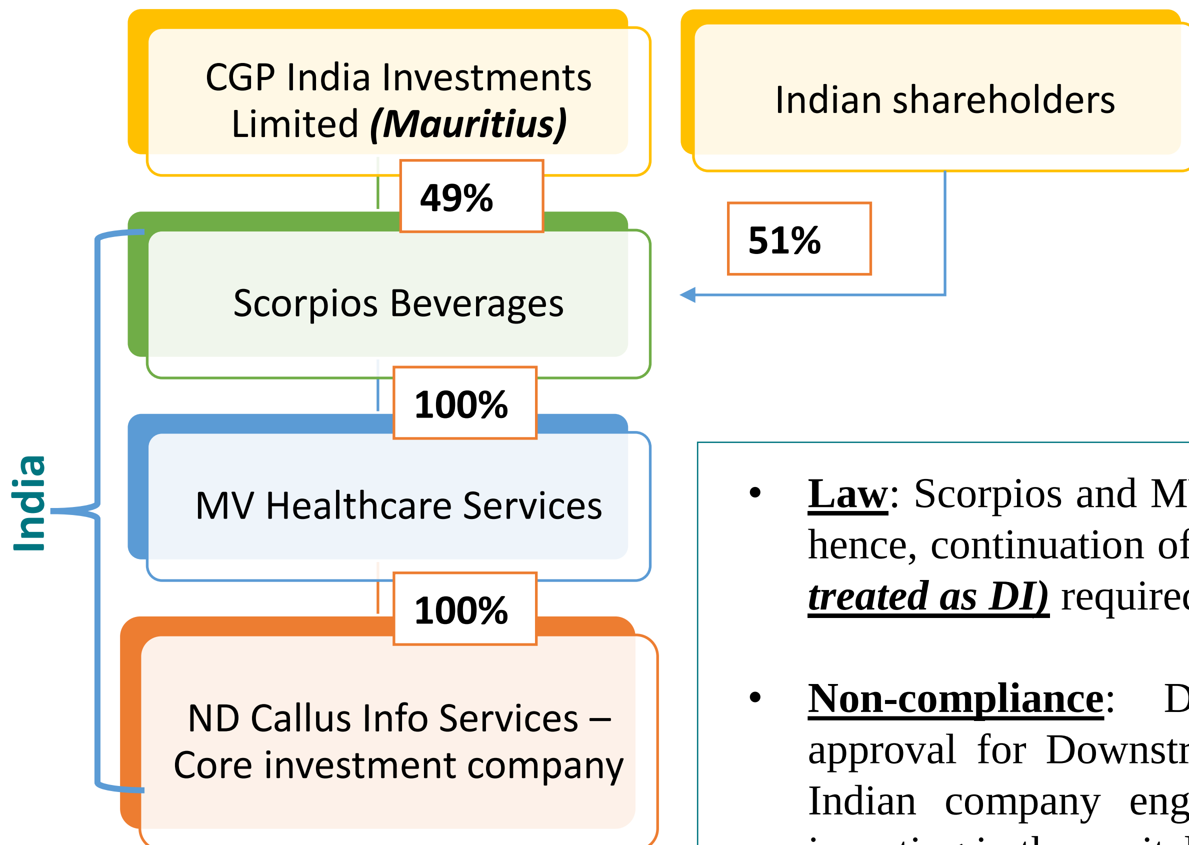
# Downstream Investment – Illustrations : I



# Downstream Investment – Illustrations : II



# Downstream Investment – Case study




- **<u>Facts</u>**: In 2014, CPG acquired remaining 51% stake in Scorpios Beverages from Indian Shareholders.

- **<u>Law</u>**: Scorpios and MV Healthcare became FOCCs – hence, continuation of investment in ND Callus ***<u>(now treated as DI)</u>*** required government approval

- **<u>Non-compliance</u>**: Did not obtain government approval for Downstream Investment by FOCCs in Indian company engaged only in the activity of investing in the capital of other Indian companies.

# Downstream Investment – Funding requirements

Indian entity making the DI shall bring in requisite funds

from abroad and not use funds borrowed in the ***domestic markets***

OR

from internal accruals (i.e., profits transferred to reserve account after payment of taxes)

**Illustration -1**

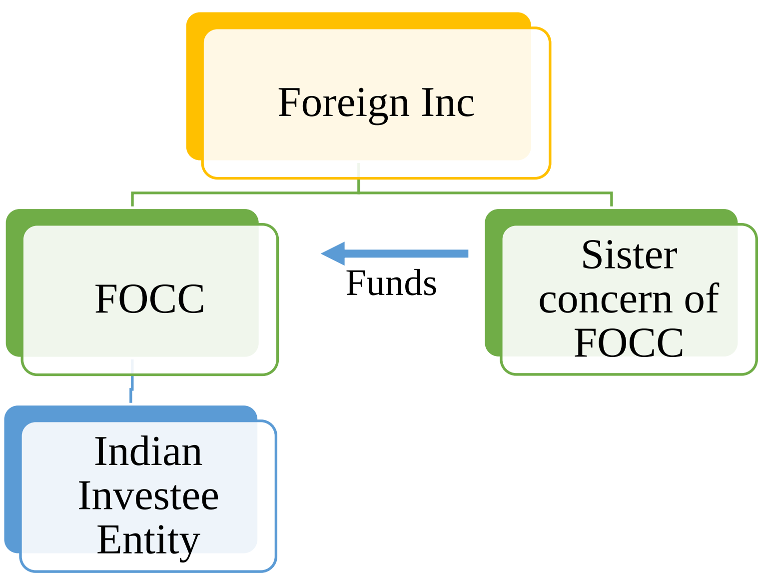
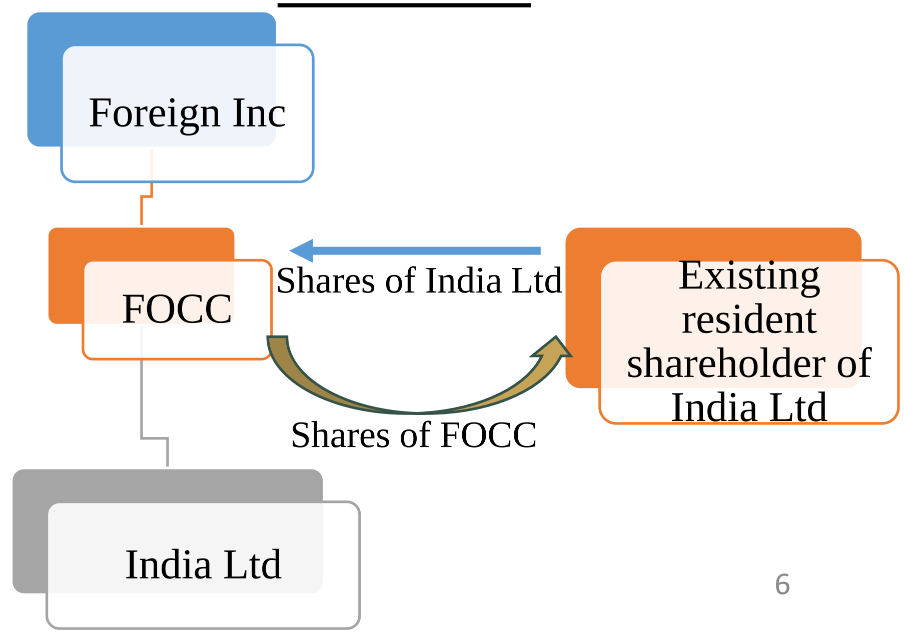



**Illustration -2**



Luthra and Luthra
LAW OFFICES INDIA

# Downstream Investment – Pricing and Reporting requirements

| Rule | Seller | Buyer | Pricing | Reporting | Remarks |
|---|---|---|---|---|---|
| 23(5)(a) | FOCC | PROI | No | Yes, Form FCTRS by FOCC | As per Master Directions |
| 23(5)(b) | FOCC | PRI | Yes | No | As per Master Directions |
| 23(5)(c) | FOCC | FOCC | No | No | As per Master Directions - Pricing and reporting guidelines do not apply in case of transfer of shares between 2 (two) FOCCs.<br><br>However, in practice, a few AD banks insist the acquiring FOCC to file Form DI afresh. |
| NA | PROI | FOCC | Law is silent | | |
| NA | PRI | FOCC | Law is silent | | |

Luthra and Luthra
LAW OFFICES INDIA

# Downstream Investment – Optionally Convertible Instruments (“OCI”)

**Question:**

Whether: (i) DI is allowed in OCI; and

(ii) if allowed, whether they are governed by NDI Rules / ECB Regulations

**Investment in OCI by FOCC is not considered as DI**

- NDI Rules defines *“equity instruments”* as equity shares, convertible debentures, preference shares and share warrants.

- FDI Policy defines *“Capital”* as equity shares; CCPS; CCDs and warrants.

Hence, OCI is not covered

**Investment in OCI by FOCC is not considered as ECB:**

Direct subscription of OCIs by a non-resident is considered as debt – as per FDI Policy.

Investment in OCI by FOCC is not covered under Regulation 7(B) of the ECB Regulations (i.e., regulation which is applicable for lending by Indian entities, other than NBFCs/ HFCs/ FIs, etc.)

Luthra and Luthra
LAW OFFICES INDIA

# Trading – Cash and carry wholesale trading – 100% Automatic

**Case study: Franchisor - Franchisee model – wholesale or retail?**

India

Foreign Inc

WOS in India - Franchisor

Franchisee

End Customers

Manufactures and/or procures **multi brand** FMCG and food products and supplies these products to franchisees (third parties)

Only the Products supplied by the Franchisor are sold by the Franchisees (third party products cannot be sold) - "standard store model" *(wherein the logo, brand, IPR of the Franchisor is used )*

Cash and Carry Wholesale trading / Wholesale trading means *sale of goods or merchandise to retailers, industrial, commercial, institutional or other professional business users or to other wholesalers and related subordinated service providers.*

Wholesale trading imply sales **for the purpose of trade, business and profession**, as opposed to sales for the purpose of personal consumption

# Trading – E-commerce – 100% Automatic

**E-commerce** - *buying and selling of goods and services including digital products over digital & electronic network*

B2B : √

B2C : X

**Inventory Model**

Inventory of goods/ services owned by e-commerce entity - sold directly to consumers. ***FDI not permitted.***

**Marketplace Model**

IT platform - act as a facilitator between buyer and seller

Not permitted to exercise ownership/ control over the inventory (i.e., *not more than 25% purchases of a vendor can be from the marketplace entity or its group companies - which shall render the business into **inventory-based**.*)

---

Prohibition in inventory model aimed at protecting India's vast unorganized retail sector *(conventional brick and mortar model)* – which can't purchase at scale and offer big discounts like heavily funded e-commerce giants

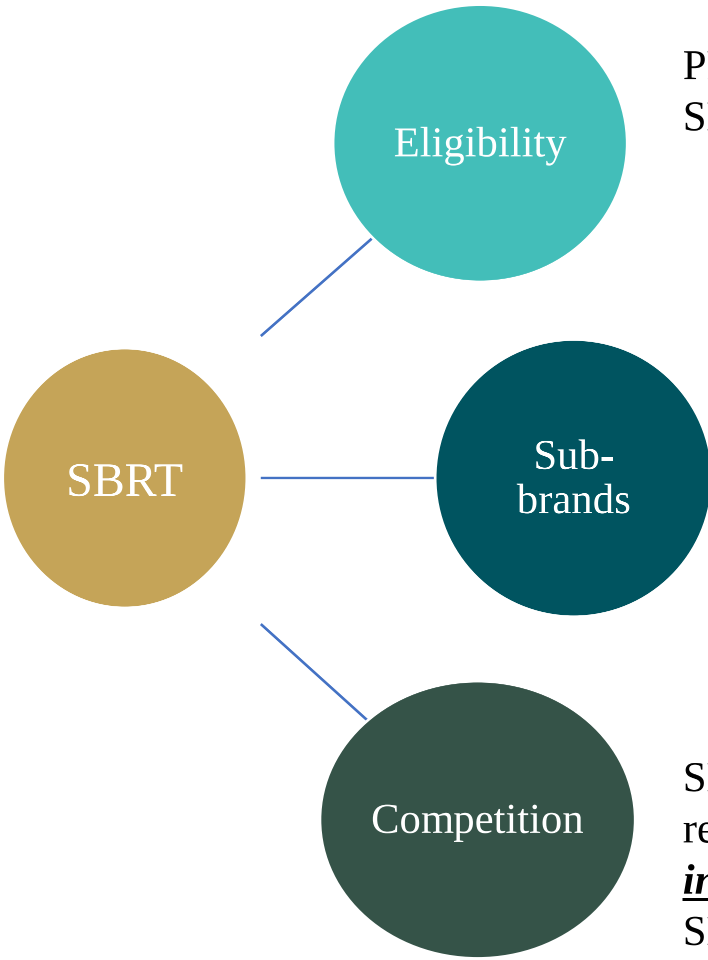
**Companies affected due to prohibition on Inventory model in FDI Policy: Amazon and Walmart-backed Flipkart**

Cannot exercise ownership on goods sold on its marketplace. Therefore, both Amazon and Flipkart developed complicated seller structures to comply with the inventory control rule while exercising some level of control over inventory.

For instance, Amazon sold 25% stake of its JV - Cloudtail (in which it earlier owned a 49%) to comply with the FDI norms, making its stake at 24%. Similarly, Flipkart has built a 'layer of B2B entities' to comply with the 25% rule.

Luthra and Luthra
LAW OFFICES INDIA

# Trading – Single Brand Retail Trading ("SBRT") – 100% Automatic




PROI (whether owner of the brand or not) may undertake SBRT in India for the specific brand

- Lack of clarity - whether Marks & Spencer, Zara, etc. selling their sub-brands in single brand retail stores is part of single brand ? For instance, *Marks & Spencer ('M&S') sell goods under sub-brands such as M&S Women, Autograph etc. under the M&S Parent brand.*
- No independent existence without main brand name
- Without a clarification from the Ministry, sub-brands are also being treated as a part of single brand retail trading only

SBRT entities may affect the sales of small domestic retailers – as seen in ***Oppo Electronics vs State Of Kerala in 2017*** - grievance of mobile phone retailers was that - SBRT outlets will adversely affect their sales. However, their writ petition was dismissed.

Luthra and Luthra
LAW OFFICES INDIA

# Trading – Manufacturing – 100% Automatic

**Whether online selling of products manufactured by wholly owned subsidiary of an overseas entity is permissible under the FDI Policy**.

- 100% FDI under the Automatic route - allowed in the manufacturing sector (whether self-manufacturing or contract manufacturing).
- Manufacturer is permitted to sell its products manufactured in India through wholesale and/ or retail, including through e-commerce, without Government approval.
- Hence, the WOS of overseas entity can sell its products online on its website.
- It should predominantly/ primarily be considered as a ‘manufacturing’ company and not a retail trading company or B2C e-commerce company. It should be allowed to first manufacture the goods *(self or through contract)* and then sell the same to end-use customers via online or offline mode and the same would not fall merely under the ambit of ‘retail trading’ or ‘B2C e-commerce (vis-a-vis inventory model)’.

Luthra and Luthra
LAW OFFICES INDIA

# Other financial services

FDI is allowed in unidentified / other financial services in the following manner:

i. **<u>Regulated activities – 100% automatic route</u>**: FDI up to 100% under the automatic route is allowed, subject to certain conditions such as (i) regulation of the activities by financial regulators (i.e., SEBI, RBI, IRDA, PFRDA or any other financial sector regulator), (ii) minimum capitalization norms.

ii. **<u>Unregulated/ partially regulated activities – government approval route</u>**: Activities which are (i) not regulated by any financial sector regulator or (ii) where only part of the financial services activity is regulated or (iii) where there is doubt regarding the regulatory oversight, FDI up to 100% is allowed under Government approval route subject to conditions such as **<u>following minimum capitalization norms</u>**.

| Nature of activity | Activities | Minimum capitalization |
|---|---|---|
| **Fund based activities** | Merchant Banking, Under Writing, Portfolio Management, etc. | USD 20 million |
| **Non-fund based activities** | Investment advisory services, Financial Consultancy, etc. | USD 2 million |

Luthra and Luthra
LAW OFFICES INDIA

# Procedure of approval route

1. Online Filing of Application through the National Single Window System (NSWS) portal
2. DPIIT to identify the concerned Ministry/ Department and assign the proposal **within 2 days** (including forwarding the same to MEA, RBI, MHA (for security clearance))
3. Initial scrutiny of the proposal and documents attached therewith, and seeking relevant additional information/ documents from the applicant to be completed **within 12 days**
4. Proposals requiring clarification from FDI Policy perspective be referred to DPIIT. Clarification to be submitted **within 2 weeks**
5. Submission of comments by MHA, MEA and any other consulted Ministry/ Department / RBI/ Regulator / Stakeholder **within 6 weeks**
6. Upon completion of processing of proposal, Competent Authority shall convey its decision to the applicant with a copy to all consulted Ministries/ Departments, Regulatory Agencies and DPIIT through NSWS Portal itself **within 4 weeks**.

Luthra and Luthra LAW OFFICES INDIA

# Cabinet Committee on Economic Affairs

**Role of Cabinet Committee on Economic Affairs (CCEA):**

Proposals involving total foreign equity inflow of ***more than Rs 5000 crore***, Competent Authority shall place the same for consideration of CCEA.

After the receipt of the decision of CCEA, letter conveying decision shall be issued within **1 week**.

**Examples**:

- February 2019 - CCEA approved foreign investment of more than Rs. 5000 crore and up to Rs.25,000 crore by way of a Rights issue of M/s. **Vodafone Idea Limited**
- November 2020 – CCEA approved FDI of Rs. 2480.92 crore in M/s. **ATC Telecom Infrastructure** Private Limited by M/s. ATC Asia Pacific Pte. Ltd.
- August 2021 - CCEA approves Rs 15,000-crore FDI proposal of **Anchorage Infrastructure Investment Holding**

Luthra *and* Luthra

LAW OFFICES INDIA

***"KNOWLEDGE SPEAKS….***

***….WISDOM LISTENS"***

**THANK YOU**