

CHANGES IN FOREIGN DIRECT POLICY

In its latest review of consolidated Foreign Direct Investment (FDI) Policy, Department of Industrial Policy & Promotion (DIPP), issued Circular 1 of 2011 (31st March, 2011,) that came into effect from 1st April, 2011.

This note recaps the major changes that have been introduced in the FDI Policy vide Circular 1 of 2011. The changes that have been introduced are as follows:

1. Pricing of Convertible instruments:

Under the earlier FDI policy, the convertible instruments could be issued only when their conversion price was decided upfront at the time of issuance. Such upfront determination of conversion rate eliminated any scope of commercial benefit of investing through convertible instruments. Therefore, DIPP with a view to recognize and address this issue has amended the FDI policy. The new FDI Policy provides that instead of specifying the conversion price of convertible instruments upfront, companies will now have the option to prescribe the conversion formula, subject to FEMA/SEBI pricing guidelines. The introduction of conversion formula will help the recipient companies to obtain a better valuation of convertible instruments.

2. Shares against non cash consideration:

The FDI policy allows issuance of shares to foreign investors only against the remittance received in cash via normal banking channels. However, the exemption to this rule is conversion of External Commercial Borrowings (ECB), lump sum technical know-how fee and royalty fee into equity. However, in the new FDI policy the following additional transactions have been accepted for conversion to equity:

- a. import of capital goods/ machinery/ equipment (including second-hand machinery);
- b. Pre-operative/ pre-incorporation expenses (including payments of rent, etc.).

However, the point to be noted here is that such issue of shares for the purposes described above continues to be under the approval route. Thus, it requires parties to make an application to the Government and obtain permission of FIPB before carrying out the transaction.

3. Removal of No objection Certificate from previous ventures:

Under the previous FDI Policy, a foreign investor was required to obtain a no-objection letter from the existing Indian joint venture partner in case the foreign investor intended to invest in the same field where they had a previous joint venture. This condition has been completely abolished under the Circular 1 of 2011. Going forward this requirement does not apply to any joint venture past or present and foreign investors would be free to enter into new ventures in the same field without the NOC of their existing Indian partner.

4. Downstream Investment:

The categorization of companies as 'investing companies', 'operating companies' and 'investing-cum-operating companies' for the purpose of downstream investment has been done away with. The new FDI policy has simplified the categories of companies for the purpose of downstream investment into:

- a. Companies owned or controlled by foreign investors, and
- b. Companies owned and controlled by Indian residents.

5. Sector Specific entry condition:

Under the earlier policy, FDI was allowed for development of seeds only if such development was done under controlled conditions. The new FDI Policy broaden the category and allows FDI in development and production of Seeds and planting material, even if the same has not been done under controlled condition.