

Corpsec Hotline

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GOVERNMENT MULLS COMPOSITE CAPS FOR FDI

In the present market conditions, the government has taken various positive steps to allow companies to raise capital through equity as well as debt routes. A foreign investor can invest in Indian companies either under the Foreign Direct Investment (“FDI”) route by making direct investments in the Indian company or by subscribing to the securities of the company through a recognized stock exchange under the Foreign Institutional Investment (“FII”) route. A foreign investor can also invest under the Foreign Venture Capital Investment (“FVCI”) route, subject to the overall sectoral cap. Under the extant exchange control regulations, specific sectoral caps are provided for making FDI investments across permitted sectors. As regards, investments under the FII route, a company is not permitted to allow, more than 24% of its paid-up capital for FII investment, until the board has passed a special resolution permitting issue of more than 24% of its paid-up capital to FIIs (subject to sectoral limits). On the other hand, a single FII is not permitted to hold more than 10% of equity in a company.

These sectoral limits are specified by the ministry of finance in consultation with the relevant ministers. While, some ministries provide the investment cap for FII investments separately, certain ministries prefer to provide specific classification for FII investments and FDI investments within the permitted sectoral cap. Yet, there are several sectors for which there are no specific FII investment guidelines.

Sectors which have specific FDI and FII limits		
S. No	Sectors	Limit
1.	Private Banking	74% (FDI + FII)
2.	Broadcasting <ul style="list-style-type: none"> i. FM Radio ii. Cable network iii. Direct-To-Home iv. Setting up hardware facilities such as up-linking, HUB, etc v. Up-linking a News & Current Affairs TV Channel 	FDI + FII investment upto 20% 49% (FDI+FII) 49% (FDI+FII). FDI component not to exceed 20% 49% (FDI+FII) 26% (FDI+FII)
3.	Commodity Exchanges	49% (FDI+FII). Investment by FII under Portfolio Investment Scheme limited to 23%, while investment under FDI Scheme is limited to 26%. FII purchases are restricted to secondary market only. While, no foreign investor / entity, including persons acting in concert, is permitted to hold more than 5% of the equity in a commodity exchange..
4.	Credit Information Companies	49 % (FDI+FII). Investment by FII under Portfolio Investment Scheme limited to 24% only in companies listed at the Stock Exchanges within the overall limit of 49% foreign investment.

Present interpretation of investment norms

This has caused confusion for the companies, investors and government departments alike regarding the interpretation of investment norms. While, the department of industrial policy and promotion (“DIPP”) and the Reserve Bank of India (“RBI”) have at different times have taken a view that FII investments can be made over and above the sectoral caps, a contrary view has been taken by the ministry of finance, and has maintained that the FII investments are covered under the existing sectoral cap, even in sectors where there is no specific mention regarding the FII investment cap.

The issue came into public eye, when DIPP proposed FII investment in the real estate sector over and above of the existing FDI limit. Around the same time, it was reported¹ that RBI too made a liberal interpretation of the sectoral limits and said that FIIs could pick up a stake in airlines beyond the extant FDI cap of 49% under the FII route. The

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rationale given by the RBI was that, the sectoral cap of 49% was not stipulated as a composite limit. Separately, DIPP had circulated a draft Cabinet note seeking views from the ministries concerned on its proposal to relax FII investments in sectors that have composite caps. The proposal would have provided flexibility to companies to raise equity beyond the existing sectoral cap, under the FII route, where there are is a specific cap on the FII investments. However, as per the newspaper reports, last year in September², the discussions were laid to rest, when the finance ministry refused to accept the proposal made by the DIPP.

The Proposal

As per recent newspaper reports³, the government is said to have considered a departure from its existing stance on calculation of sectoral caps, the government has proposed providing a composite foreign investment cap of both FDI and FII across all sectors. The proposal would be considered by the committee of secretaries and then would be placed before the Cabinet for approval. The present move is aimed to provide a standardize investment policy across all the sectors, and provide greater flexibility to companies while to raise capital through FDI and FII routes.

Effect

Currently, the government proposes the applicability of relaxations to those sectors that have composite limits and for which there are no separate statutes or rules that specifically govern investment under the FDI route. As companies may intend to internally reorganize their equity structure to avail the benefit of the proposal, the government is contemplating providing companies a window period of six months to comply with the new composite sectoral caps. This proposal can be said to be in line with the recent government policies, which aim to provide stimulus to specific sectors. However, at present it is unclear, whether the proposal would provide a similar relaxation to FIIs in respect of their equity holding in a single company, beyond the existing 10% limit.

From the procedural aspect, a single sectoral limit would help regulators to monitor foreign investment and prevent violations in an efficient manner. While, for companies in which sectoral cap is restricted to 49%, the government has proposed that such company should be owned and controlled by resident Indians, so that the beneficial ownership vests with resident Indians.

Though the intent seems to provide the resident Indian investors with the control over the companies, however it would be interesting to see government's outlook, in cases where the foreign investor may exercises control over a company by virtue of the differential voting rights attached to the shares held by him. Also, a foreign investor can exercise negative control in case he is holding a substantial holding in the company.

Conclusion

The proposal to provide composite limits can be regarded as a pro-active measure providing flexibility to companies to permit FII investments beyond the permitted FIIs limit, however, the benefits are primarily focused on sectors which have separate sectoral caps for FDI and FII investments. Therefore, it would also be essential to keep a close watch on the final proposal and government's view regarding FII investments in sectors where there are no specific regulations for investments by FIIs.

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1. [Financial Express dated June 7, 2007](#)
 2. [Economic Times Dated September 29, 2008](#)
 3. [Economic Times dated January 30, 2009](#)

- Shikhar Kacker & Vyapak Desai

You can direct your queries or comments to the authors

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