Corpsec Hotline

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'ROAD CLOSED' FOR FII INVESTMENT IN IPOS OF RETAIL COMPANIES

As reported in the Business Standard, the Government has, while clarifying on the policy guidelines for the sectoral cap in the retail sector, conveyed to the investment bankers that the FIIs will be prohibited from participating in the book-building process in retail sector IPOs, as buying shares through the primary market is considered as Foreign Direct Investment (FDI). The FIIs will, however, be allowed to buy shares up to 24% only from the secondary market, after the listing of the shares.

Regulatory Provisions

Schedule 1 to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 (RBI Regulations), which provides for investment under the FDI scheme, allows FDI up to 49% in single-brand retail chains, but prohibits FDI in multi-brand retail chains.

As against the above, Schedule 2 of the RBI Regulations, which provides for investment by FIIs under the Portfolio Investment scheme, allows the SEBI-registered FIIs to invest up to 24% of the total paid-up capital of an Indian company, both through primary as well as secondary market. The Indian company is allowed to increase this limit up to the sectoral cap / statutory ceiling, by passing a resolution by the board of directors followed by a special resolution by its general body.

The Schedule 2 simultaneously allows the FIIs to purchase shares of an Indian company through offer / private placement, subject to the ceilings specified therein, provided that in case of a public offer, the price of the shares to be issued to the FIIs is not less than the price at which shares are issued to residents.

Implications

While the intention of the Government may be to impose the restrictions on the FIIs in line with the FDI policy, it goes against the provisions of Schedule 2 of the RBI Regulations.

Further, the news report seems to suggest that the restriction is only on multi-brand retail companies. In fact, the Foreign Investment Promotion Board, while issuing clarifications in respect of FII investment in the real estate companies which have non-FDI compliant projects, have clarified their position that the FDI is distinct from the FII investment and hence, it is unclear why the ratio should differ in respect of retail companies.

It, however, looks that the proposed restriction would hamper the business plans of Reliance Industries, Bharti and Aditya Birla group, who are planning to enter the multi-brand retail industry in a big way.

- Kishore Joshi & Siddharth Shah
You can direct your queries or comments to the authors

Source: The Business Times, November 10, 2006 - Singapore edition

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