
CRITERIA FOR FOREIGN DIRECT INVESTMENT IN INDIA

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Introduction

Overview

Besides being a crucial investment for India's economic growth, foreign direct investment (FDI) plays a significant role as a substantial source of non-debt financial resources for the country's development. Foreign companies invest in India to leverage factors like cost-effective labor, as well as special investment incentives such as tax exemptions. This not only benefits the investing companies but also facilitates the transfer of technological expertise and the creation of job opportunities in the host country.¹

The Indian government has published a favourable policy environment and a powerful business climate, ensuring a continuous inflow of foreign capital into the nation. In recent years, the government has implemented various initiatives to promote FDI, including relaxing FDI regulations in sectors such as defense, public sector oil refineries, telecommunications, power exchanges, and stock exchanges, among others.

Research Problem

In the field of international investment law, there always problem for transferring of money from home state to host state, there for transferring they have to move the procedure and face obstacles related to permits, license and compliance with the local laws which takes time and cost for FDI. Sometimes government changes policy, market risk can change the consumer demand and that impact the FDI. Some countries can lead to demands for bribes and delays in obtaining necessary approvals. To mitigate these challenges, investors often conduct through due diligence, assesses

¹ (No date) *Ministry of External Affairs*. Available at: <https://eoi.gov.in/eoisearch/MyPrint.php?1148%3F001%2F0010> (Accessed: 14 October 2023).

the risk, and develop strategies to address the specific issues associated with foreign direct investment in a particular country and industry.

Research objectives

The objectives of the research are:

- ☐ To know the criteria of foreign direct investment in India and outside India
- ☐ To analyse the ways in which FDI flows in India.
- ☐ Government measures to increase FDI in India

Research Questions

- ☐ What are the FDI routes in India? How government face challenges sectors where FDI is prohibited?
- ☐ What government measures to increase FDI in India and how regulatory framework works in India?

Hypothesis of the study

The hypothesis of this research paper is to enlighten the routes of Foreign Direct Investment in India and the measures government take to prohibit foreign direct investment in India in some of the sectors. Light up the governance on Foreign Direct Investment and challenges faced by the government and company and how regulatory framework works on FDI.

Research methodology

The purpose of this paper the researcher will be using the doctrinal research methodology wherein the researcher will be going through the provisions of the FDI regulation implemented in India. For the information concerned, secondary sources such as books and online journals will be referred to along with research articles for the purpose of this research paper.

Review of literature

- Bhawana Rawat and Shakeel Ahamed “Foreign Direct Investment in Service Sector: A case of Education sector” (2011), pp.294-308, Journal of world investment trade. The chapter tells briefly about the setting of Foreign Direct Investment India and how it affect the economy by importing the investment, and helps in improving the unemployment.
- Williams, Mark J “Foreign Direct Investment in India” (1988) pp 609-686, Foreign Investment Policy, SCC Online Blog The paper talks about the policy framed in different sectors of investment and the methods which are used to do investment which are as follows.
- Rakesh Kumar and Pinki Rani “Foreign direct Investment” Volume 11 Issue 2(2)/19, SCC Online Blog routes of Foreign direct investment in India and how it affects the government and private sector while investing by any of those routes.
- P Sai Rani and Saurabh Kumar Ghosh, View of study of Foreign Direct investment in India, it shows the effect of the investment by allotting the percentage on the company and how much percentage of share a company maximum can bought.
- V. K. Bhalla, International Financial Management (2011), this book talks about the management of international investment financially with respect to foreign direct and following the foreign policy for doing the investment on particular company.
- Amit Shekhar, FOREIGN INVESTMENT IN INDIA AND ITS REGULATORY FRAMEWORK AHLAWAT & ASSOCIATES (2023), this article talks about the regulatory framework for investment of FDI and which all framework are included while doing investment.

FOREIGN DIRECT INVESTMENT

Foreign direct investment, often abbreviated as FDI, occurs when an entity from one country invests in another country by purchasing existing companies or expanding its operations within the host country. Foreign direct equity inflows are considered a substantial driver of economic

growth, preferred for their non-debt nature and stability, with returns tied to the performance of the projects funded by foreign investors. FDI not only contributes to a country's economic growth but also brings in new technology, management expertise, innovative ideas, skills, knowledge, increased employment opportunities, and enhanced infrastructure.

The introduction of FDI in India dates back to 1991 when it was initiated through the Foreign Exchange Management Act (FEMA) by Dr. Manmohan Singh, who was the finance minister at the time. In 1990, FDI in India began at a foundational level with an initial investment of 1 billion dollars.

Setting of FDI²

Globalization, which resulted in the integration of various nations and the gradual dissolution of physical borders, has delivered a range of advantages to "Third world" countries such as India. As a result of the liberalization of policies and procedures related to foreign capital in 1991, India has experienced a significant influx of foreign investments, particularly in the form of Foreign Direct Investment (FDI). India, whose economic growth has been significantly attributed to foreign capital while domestic capital has been relatively limited, has witnessed a substantial shift in the sectors contributing to the nation's growth.

In the past decade or so, the growth of the Indian economy appears to be primarily driven by the contributions of the services sector.

In India, education has been a significant and long-standing concern, with consistent efforts to achieve 100% literacy and improve the quality of education. However, a critical challenge has been the substantial gap between the availability of educational infrastructure and the number of individuals seeking education. As a result, there has been ongoing debate about the possibility of allowing foreign direct investment (FDI) in the education sector.

The predominant form of foreign investment in India³ is often referred to as "foreign

² REDIRECTING..., <https://heinonline.org/HOL/P?h=hein.journals%2Fjworldit13&i=298> (last visited Oct 22, 2023).

³ <https://heinonline.org/HOL/Page?handle=hein.journals%2Fcjtl26&id=617&collection=sccjournals&index=#> (last visited Oct 22, 2023).

collaboration." This term carries a specific meaning, signifying a legal association between either a foreign investor or a foreign technology provider and an Indian entity or individual. Under this arrangement, the foreign party commits to participating in an Indian joint venture company or providing technology, technical information, machinery, and equipment. The legal framework pertaining to foreign collaboration in India is intricate, involving a network of formal legal statutes and official policy statements. For foreign investors looking to engage in such collaborations, navigating this complex system can be a bewildering journey without a thorough understanding of these laws and policies and their intricate interconnections. This document aims to provide a comprehensive examination of the legal and policy regulations governing foreign collaboration in India. Furthermore, it delves into the interplay between the law and official policy in a developing nation where limited economic resources have prompted government involvement in resource allocation and utilization. FDI is often defined as "an investment in one country's business by a company from another country." Typically, this investment involves entering the production sector, either through the acquisition of a company in the host country or by expanding the operations of an existing business there. These investments can occur for various reasons, such as capitalizing on lower labour costs and benefiting from special investment incentives, such as tax exemptions, provided by the host country.

The Indian companies receive Foreign Direct Investment from two different routes⁴:

- ☐ Automatic Route
- ☐ Government Route

Automatic Route: FDI is allowed under the automatic route without prior approval either of the government or the Reserve Bank of India in all activities/sectors as specified in the consolidated FDI policy, issued by the government of India from time to time. Agriculture, Plantation, Construction Development, Industrial Parks, Railway Infrastructure, Financial Services, Insurance, Pension Sector, etc.

⁴ Ramesh Kumar & Pinki Rani, IJMER.S3.AMAZONAWS.COM SCC ONLINE, [https://ijmer.s3.amazonaws.com/pdf/volume11/volume11-issue2\(2\)/19.pdf](https://ijmer.s3.amazonaws.com/pdf/volume11/volume11-issue2(2)/19.pdf) (last visited Oct 22, 2023).

Government Route: FDI in activities not covered under the automatic routes requires prior approval of the government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance. Print media, Satellites-establishment and operations, Banking-public sector, etc.

The rate of Foreign Direct Investment (FDI) in India is not uniform and varies across different sectors⁵. It can be 26%, 49%, 51%, 74%, or even 100% in some industries, meaning that the entire funding for these sectors can come from foreign entities. Furthermore, specific industries may have different FDI rates and pathways. For example, in sectors like Defense and Telecom services, FDI rates vary, with up to 49% allowed through the automatic route and government approval required beyond 49%.

Certain industries are strictly off-limits for FDI under any circumstances. Examples include the tobacco industry, lottery and gambling businesses, chit funds, Nidhi companies, and trading in Transferable Development Rights (TDRs). In sensitive sectors like defense, insurance, and media, there have always been debates regarding FDI due to concerns about national security and integrity. Consequently, FDI caps apply in many of these sectors. For instance, the defense industry permits only up to 49% foreign direct investment through the automatic route, beyond which government approval is mandatory.

Scope of FDI⁶

India, as the world's third-largest economy in terms of purchasing power parity, holds a considerable appeal for foreign direct investment (FDI). The Indian government has made efforts to eliminate FDI restrictions in many sectors. However, there remain certain critical areas, such as retailing and insurance, where opposition from local Indian individuals and companies persists. India can potentially attract investment in several key economic sectors.

Some of the place where FDI can be attracted are:

⁵ P Sai Rani & Saurabh Kumar Ghosh, VIEW OF A STUDY ON FOREIGN DIRECT INVESTMENT IN INDIA, <https://archives.palarch.nl/index.php/jae/article/view/6461/6300> (last visited Oct 22, 2023).

⁶ V.K. BHALLA, INTERNATIONAL FINANCIAL MANAGEMENT (2011).

1. Telecommunication
2. Apparels
3. Information Technology
4. Pharma
5. Auto parts
6. Jewellery
7. Chemicals

In recent years, foreign investments have indeed exhibited an upward trajectory. However, the stringent FDI policies have acted as obstacles to the growth of this sector. Nevertheless, India is poised to emerge as a significant FDI destination in the Asia-Pacific region, primarily due to economic reforms aimed at boosting foreign investment and the deregulation of this crucial sector. India boasts technical expertise, a pool of skilled managers, and a rapidly expanding middle-class market, exceeding 300 million individuals, making it an appealing market.

Challenges faced by the Government

In FDI scheme Indian companies issues shares and debenture to a person resident outside India shall also be paid:

- ☐ Inward remittance through normal banking channels
- ☐ Debit to NRE/ FCNR account of a person concerned maintained with an AD category I bank.
- ☐ Conversion of royalty/ lump sum/ technical know how fee due for payment or conversion of ECB, shall be treated as consideration for issue of shares.
- ☐ conversion of import payables / pre incorporation expenses / share swap can be treated as consideration for issue of shares with the approval of FIPB
- ☐ debit to non-interest bearing Escrow account in Indian Rupees in India which is opened with the approval from AD Category – I bank and is maintained with the AD Category I

bank on behalf of residents and non-residents towards payment of share purchase consideration.

If shares or convertible debentures are not issued within 180 days from the date of receiving the inward remittance or debiting the NRE / FCNR (B) / Escrow account, the funds must be returned. Additionally, the Reserve Bank may, under certain conditions and upon receiving an application with valid justifications, allow an Indian company to either refund the amount or allocate shares when the consideration received for the issuance of securities remains outstanding for more than 180 days from the initial receipt date.

Some of the sectors where FDI are not allowed

FDI is prohibited under the Government Route as well as the automatic route, where FDI is not allowed in either ways. Some are the sectors are:

- ☐ Atomic Energy
- ☐ Lottery Business
- ☐ Gambling and Betting
- ☐ Business of Chit Fund
- ☐ Nidhi Company
- ☐ Agricultural (excluding Floriculture, Horticulture, Seeds, Animal Husbandry etc.)
- ☐ Housing and real-state businesses
- ☐ Trading in Transferable Development Rights (TDRs).
- ☐ Manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

The perspective of advantages and disadvantages

In the realm of foreign direct investment (FDI), the benefits and drawbacks are often subjective. What may be advantageous for a Multinational Enterprise (MNE) might not necessarily be advantageous for the host country where the investment takes place. Conversely, in certain situations, the deal may turn out to be more favorable for the host country, contingent on how the investment unfolds. Ideally, there should be a multitude of advantages for both the MNE and the host country, which is frequently a developing nation.

The major benefits of FDI are:

- ☐ Improve the position of the country.
- ☐ Doors open for the employment and increase in production.
- ☐ Increase in capital by international investment.
- ☐ Help in transfer of new technologies, management skills, intellectual property.
- ☐ Increase competition within the local market and this bring higher efficiencies.
- ☐ Help in increasing exports.
- ☐ Increase tax revenues.

Law and regulatory framework in Foreign Direct Investment⁷

The primary regulation governing all foreign exchange transactions in India is the Foreign Exchange Management Act of 1999, commonly known as FEMA. This legislation ensures adherence to the guidelines and directives of the Reserve Bank of India, which serves as the central bank of the country.

⁷ Amit Shekhar, FOREIGN INVESTMENT IN INDIA AND ITS REGULATORY FRAMEWORK AHLAWAT & ASSOCIATES (2023), <https://www.ahlawatassociates.com/blog/foreign-investment-in-india-and-its-regulatory-framework/> (last visited Oct 23, 2023).

Additional regulatory bodies encompass the Ministry of Commerce and Industry, the Securities and Exchange Board of India (SEBI), and the Department for Promotion of Industry and Internal Trade.

Foreign investment proposals under the government route used to be evaluated by the Foreign Investment Promotion Board (FIPB), which was the highest authority responsible for overseeing and encouraging foreign investments in India. However, in 2017, the FIPB was disbanded, and the Department for Promotion of Industry and Internal Trade (DPIIT) assumed the role of handling all foreign investment proposals and shaping policies regarding foreign investments in India. Currently, the evaluation of foreign investment proposals is managed through the Foreign Investment Facilitation Portal (FIFP), which is operated by the DPIIT.

The FIFP is an online platform designed to simplify and speed up foreign direct investment in India. It serves as a comprehensive digital interface where investors can access information, seek approvals, and access various services related to foreign investment, including FDI consulting services.

Manohar Lal Sharma vs Union of India⁸

The revised FDI policy is anticipated to stimulate job creation, enhance infrastructure, and elevate product quality. Direct sales to organized retailers are expected to notably benefit farmers, as a World Bank-commissioned study indicates a 60% higher profit for farmers selling directly to these retailers compared to selling in traditional markets. This information is supported by an Indian government-initiated study conducted by the Indian Council for Research on International Economic Relations (ICRIER) in 2008, which concluded that both organized and unorganized retail sectors not only coexist but also experience significant growth. Writ Petition is dismissed with no order as to costs. Interlocutory Applications stand disposed off.

P. Chidambaram Vs. Central Bureau of Investigation⁹

As a result, the previous judgment from the Delhi High Court on September 30, 2019, in Bail

⁸ Manohar Lal Sharma vs. Union of India (UOI) and Ors. (01.05.2013 - SC) : MANU/SC/0520/2013

⁹ P. Chidambaram vs. Central Bureau of Investigation (22.10.2019 - SC) : MANU/SC/1456/2019

Application No. 2270 of 2019 is overturned. The appeal from SLP(Crl.) No. 9269 of 2019 is approved. The individual appealing is to be granted bail, provided they are not required in any other case, by posting bail bonds of Rs. 1,00,000/- along with two sureties of the same amount to the satisfaction of the Special Judge (PC Act), CBI-06, Patiala House Courts, New Delhi. If the passport is not already submitted, it should be handed over to the Special Court, and the appellant cannot leave the country without the Special Court's permission. They must also make themselves available for questioning when necessary. Additionally, the appeal stemming from SLP(Crl.) No. 9445 of 2019 brought by the CBI is dismissed. The High Court's opinions in the previous judgment should not influence the trial or any other proceedings. It's emphasized that the findings in this judgment are solely for assessing regular bail in the CBI case and should not impact any other legal processes.

Vodafone International Holding B.V. vs Union of India and others¹⁰

It find it challenging to agree with the conclusions made by the High Court that the transfer of CGP shares by HTIL to Vodafone constitutes the transfer of a capital asset under Section 2(14) of the Indian Income Tax Act. Moreover, I disagree that the associated rights and entitlements from FWAs, SHAs, Term Sheet, loan assignments, brand licenses, etc., are an inherent part of CGP shares, thereby subject to capital gains tax. Therefore, the demand for approximately Rs. 12,000 crores as capital gains tax seems unjust as it essentially penalizes capital investment without legal backing. Consequently, this demand is invalidated. I also support all the other directives outlined in the judgment delivered by the Lord Chief Justice.

Hence, we overturn the challenged judgment of the Bombay High Court dated 8.09.2010 in Writ Petition No. 1325 of 2010. Consequently, the Civil Appeal is approved without any specific order regarding expenses. The Department is instructed to refund the amount of Rs. 2,500 crores, which the Appellant deposited based on our interim order, along with an interest rate of 4% per annum within two months starting today. The interest will be computed from the date the Department withdrew the sum from the Registry of the Supreme Court until the payment date. Additionally,

¹⁰ Vodafone International Holdings B.V. vs. Union of India (UOI) and Ors. (20.01.2012 - SC) : MANU/SC/0051/2012

the Registry is instructed to return the Bank Guarantee provided by the Appellant within four weeks.

Conclusion

Foreign investment remains a significant catalyst for economic growth in India. The regulatory framework governing foreign investment has witnessed substantial changes aimed at enhancing the ease of doing business and luring more foreign capital. The Indian government's efforts to relax FDI regulations, raise sectoral limits, and simplify the approval process underscore its dedication to fostering a favorable environment for foreign investors.

These regulatory authorities, while encouraging investment, also ensure that national interests are protected, thereby creating a secure and supportive setting for foreign investors, which in turn promotes economic progress and strengthens global partnerships. The regulatory landscape for FDI is continuously evolving, with ongoing reforms and initiatives designed to attract more foreign capital, promote technology transfer, and deepen international collaborations for mutual benefit. As India further opens up its economy, foreign investors can anticipate a surge in opportunities and a more investor-friendly environment.

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