PROFESSIONAL PROGRAMME

SUPPLEMENT FOR

STRATEGIC MANAGEMENT, ALLIANCES AND INTERNATIONAL TRADE

MODULE 3 - PAPER 5

(Relevant for Students Appearing in December, 2015 Examination)

STRATEGIC MANAGEMENT, ALLIANCES AND INTERNATIONAL TRADE

Module III

PAPER-5

Chapter 10

Foreign Collaborations and Joint Ventures

DIRECT INVESTMENT OUTSIDE INDIA

A. Automatic Route

(1) In terms of Regulation 6 of the Notification (No. FEMA.120/RB-2004 dated July 7, 2004, (GSR 757 (E) dated November 19, 2004), viz. Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004, as amended from time to time.), an Indian party has been permitted to make investment/undertake financial commitment in overseas Joint Ventures (JV) / Wholly Owned Subsidiaries (WOS), as per the ceiling prescribed by the Reserve Bank from time to time.

An Indian party means

- A company incorporated in India; or
- A body created under an Act of Parliament; or
- A partnership firm registered under the Indian Partnership Act, 1932; or
- A Limited Liability Partnership (LLP) incorporated under the Limited Liability Partnership Act, 2008 making investment in a Joint Venture or Wholly Owned Subsidiary abroad.

W.e.f. July 03, 2014, the limit of Overseas Direct Investments (ODI)/ Financial Commitment (FC) to be undertaken by an Indian Party under the automatic route has been restored to the limit prevailing, as per the extent FEMA provisions, prior to August 14, 2013. It has, however, been decided that any financial commitment exceeding USD one billion (or its equivalent) in a financial year would require prior approval of the Reserve Bank even when the total FC of the Indian Party is within the eligible limit under the automatic route (i.e., within 400% of the net worth as per the last audited balance sheet.)

(2) The Indian party should approach an Authorised Dealer Category - I bank with an application in Form ODI .

(3) The total financial commitment of the Indian party in all the Joint Ventures / Wholly Owned Subsidiaries shall comprise of the following:

a. 100% of the amount of equity shares;

b. 100% of the amount of compulsorily and mandatorily convertible preference shares;
c. 100% of the amount of other preference shares;
d. 100% of the amount of loan;
e. 100% of the amount of guarantee (other than performance guarantee) issued by the Indian party;
f. 100% of the amount of bank guarantee issued by a resident bank on behalf of JV or WOS of the Indian party provided the bank guarantee is backed by a counter guarantee / collateral by the Indian party;
g. 50% of the amount of performance guarantee issued by the Indian

Foot note: *Compulsorily Convertible Preference Shares (CCPS) shall be treated at par with equity shares.*

(4) The investments/financial commitments are subject to the following conditions:

a) The Indian party / entity may extend loan / guarantee only to an overseas JV / WOS in which it has equity participation.

Indian entities may offer any form of guarantee - corporate or personal (including the personal guarantee by the indirect resident individual promoters of the Indian Party)/ primary or collateral / guarantee by the promoter company / guarantee by group company, sister concern or associate company in India provided that:

i. All the financial commitments, including all forms of guarantees and creation of charge are within the overall ceiling prescribed for the Indian party;
ii. No guarantee should be 'open ended' i.e. the amount and period of the guarantee should be specified upfront;
iii. As in the case of corporate guarantees, all guarantees are required to be reported to the Reserve Bank, in Form ODI-Part II.

b) The Indian party should not be on the Reserve Bank’s Exporters' caution list / list of defaulters.

c) All transactions relating to a JV / WOS should be routed through one branch of an Authorised Dealer bank to be designated by the Indian party.

d) In case of partial / full acquisition of an existing foreign company, where the investment is more than USD 5 million, valuation of the shares of the company shall be made by a Category I Merchant Banker registered with SEBI or an Investment Banker / Merchant Banker outside India registered with the appropriate regulatory authority in the host country; and, in all other cases by a Chartered Accountant or a Certified Public Accountant.

e) In cases of investment by way of swap of shares, valuation of the shares will have to be made by a Category I Merchant Banker registered with SEBI or an Investment Banker outside India registered with the appropriate regulatory authority in the host country. Approval of the Foreign Investment Promotion Board (FIPB) will also be a prerequisite for investment by swap of shares.

f) In case of investment in overseas JV / WOS abroad by a registered Partnership firm, where the entire funding for such investment is done by the firm, it will be in order for individual

partners to hold shares for and on behalf of the firm in the overseas JV / WOS if the host country regulations or operational requirements warrant such holdings.

g) An Indian party may acquire shares of a foreign company engaged in a bonafide business activity, in exchange of ADRs/GDRs issued to the latter in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993, and the guidelines issued there under from time to time by the Government of India, provided:

a. ADRs/GDRs are listed on any stock exchange outside India;
b. The ADR and/or GDR issued for the purpose of acquisition is backed by underlying fresh equity shares issued by the Indian party;
c. The total holding in the Indian entity by persons resident outside India in the expanded capital base, after the new ADR and/or GDR issue, does not exceed the sectoral cap prescribed under the relevant regulations for such investment under FDI;
d. Valuation of the shares of the foreign company shall be
    - as per the recommendations of the Investment Banker if the shares are not listed on any recognized stock exchange; or
    - based on the current market capitalisation of the foreign company arrived at on the basis of monthly average price on any stock exchange abroad for the three months preceding the month in which the acquisition is committed

(5) The Indian Party is required to report such acquisition in form ODI to the AD Bank for submission to the Reserve Bank within a period of 30 days from the date of the transaction.

Note:

i. Investments / financial commitments in Nepal are permitted only in Indian Rupees.
ii. Investments / financial commitments in Bhutan are permitted in Indian Rupees as well as in freely convertible currencies. All dues receivable on investments (or financial commitment) made in freely convertible currencies, as well as their sale / winding up proceeds are required to be repatriated to India in freely convertible currencies only.
iii. Investments / financial commitments in Pakistan by Indian Parties are permissible under the approval route.

Issue of guarantee by an Indian Party to step down subsidiary of JV/WOS

a) Indian Parties are permitted to issue corporate guarantees on behalf of their first level step down operating JV /WOS set up by their JV / WOS operating as a Special Purpose Vehicle (SPV) under the Automatic Route, subject to the condition that the financial commitment of the Indian Party is within the extant limit.
b) Further, the issuance of corporate guarantee on behalf of second generation or subsequent level step down operating subsidiaries will be considered under the Approval Route, provided the Indian Party indirectly holds 51 per cent or more stake in the overseas subsidiary for which such guarantee is intended to be issued.

Investment through Special Purpose Vehicle (SPV) under Automatic Route

i. Investments (or financial commitment) through this route is also permitted under the Automatic Route in terms of Regulation 6 of the Notification, subject to the

conditions that the Indian party is not included in the Reserve Bank's caution list or is under investigation by the Directorate of Enforcement or included in the list of defaulters to the banking system circulated by the Reserve Bank/any other Credit Information company as approved by the Reserve Bank. Indian parties whose names appear in the Defaulters' list require prior approval of the Reserve Bank for the investment (or financial commitment).

ii. Setting up of an SPV under the Automatic Route is permitted for the purpose of making investment (or financial commitment) in JV/WOS overseas.

Investment in unincorporated entities overseas in oil sector under the Automatic Route

i. Investments in unincorporated / incorporated entities overseas in the oil sector (i.e. for exploration and drilling for oil and natural gas, etc.) by Navaratna PSUs, ONGC Videsh Ltd (OVL) and Oil India Ltd (OIL) may be permitted by AD Category - I banks, without any limit, provided such investments are approved by the competent authority.

ii. Other Indian companies are also permitted to invest in unincorporated entities overseas in the oil sector up to the limit prescribed provided the proposal has been approved by the competent authority and is duly supported by certified copy of the Board resolution approving such investment. Investment in excess of the prescribed limit shall require prior approval of the Reserve Bank.

Method of Funding

(1) Investment in an overseas JV / WOS may be funded out of one or more of the following sources:

i. Drawal of foreign exchange from an AD bank in India;
ii. Capitalisation of exports;
iii. Swap of shares (valuation as mentioned in para B.1 (e) above);
iv. Proceeds of External Commercial Borrowings (ECBs) / Foreign Currency Convertible Bonds (FCCBs);
v. In exchange of ADRs/GDRs issued in accordance with the Scheme for issue of FCCBs and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993, and the guidelines issued thereunder from time to time by the Government of India;
vi. Balances held in EEFC account of the Indian party; and
vii. Proceeds of foreign currency funds raised through ADR / GDR issues.

In respect of (vi) and (vii) above, the limit of financial commitment vis-à-vis the net worth will not apply. However, all investments (or financial commitment) made in the financial sector will be subject to compliance with Regulation 7 of the Notification, irrespective of the method of funding.

(2) General permission has been granted to persons resident in India for purchase/acquisition of securities in the following manner:

a. Out of funds held in RFC account;
b. As bonus shares on existing holding of foreign currency shares; and
c. When not permanently resident in India, out of their foreign currency resources outside India

Capitalisation of Exports and Other Dues

i. Indian party is permitted to capitalise the payments due from the foreign entity towards exports, fees, royalties or any other dues from the foreign entity for supply of technical know-how, consultancy, managerial and other services within the ceilings applicable. Capitalisation of export proceeds remaining unrealised beyond the prescribed period of realization will require prior approval of the Reserve Bank.
ii. Indian software exporters are permitted to receive 25 per cent of the value of their exports to an overseas software start-up company in the form of shares without entering into Joint Venture Agreements, with prior approval of the Reserve Bank.

Investments in Financial Services Sector

In terms of Regulation 7 of the Notification, an Indian party seeking to make investment in an entity outside India, which is engaged in the financial sector, should fulfill the following additional conditions:

i. be registered with the regulatory authority in India for conducting the financial sector activities;
ii. has earned net profit during the preceding three financial years from the financial services activities;
iii. has obtained approval from the regulatory authorities concerned both in India and abroad for venturing into such financial sector activity; and
iv. has fulfilled the prudential norms relating to capital adequacy as prescribed by the concerned regulatory authority in India.

Investment in Equity of Companies Registered Overseas / Rated Debt Instruments

(i) Portfolio Investments by Listed Indian Companies

Listed Indian companies are permitted to invest up to 50 per cent of their net worth as on the date of the last audited balance sheet in (i) shares and (ii) bonds / fixed income securities, rated not below investment grade by accredited / registered credit rating agencies, issued by listed overseas companies.

(ii) Investment by Mutual Funds

Indian Mutual Funds registered with SEBI are permitted to invest within an overall cap of USD 7 billion in:

a. ADRs / GDRs of the Indian and foreign companies;
b. equity of overseas companies listed on recognised stock exchanges overseas ;
c. initial and follow on public offerings for listing at recognized stock exchanges overseas;
d. foreign debt securities in the countries with fully convertible currencies, short-term as well as long-term debt instruments with rating not below investment grade by accredited/registered credit agencies;
e. money market instruments rated not below investment grade;

f. repos in the form of investment, where the counterparty is rated not below investment grade. The repos should not, however, involve any borrowing of funds by mutual funds;
g. government securities where the countries are rated notbelow investment grade;
h. derivatives traded on recognized stock exchanges overseasonly for hedging and portfolio balancing with underlying as securities;
i. short-term deposits with banks overseas where the issuer is rated not below investment grade; and
j. units / securities issued by overseas Mutual Funds or Unit Trusts registered with overseas regulators and investing in (a) aforesaid securities, (b) Real Estate Investment Trusts (REITS) listed on recognized stock exchanges overseas, or (c) unlisted overseas securities (not exceeding 10 per cent of their net assets).

(2) A limited number of qualified Indian Mutual Funds, are permitted to invest cumulatively up to USD 1 billion in overseas Exchange Traded Funds as may be permitted by SEBI.

(3) Domestic Venture Capital Funds / Alternative Investment Funds registered with SEBI may invest in equity and equity linked instruments of off-shore Venture Capital Undertakings, subject to an overall limit of USD 500 million.

(4) General permission is available to the above categories of investors for sale of securities so acquired.

B. Approval of the Reserve Bank

(1) Prior approval of the Reserve Bank would be required in all other cases of direct investment (or financial commitment) abroad.

(2) Reserve Bank would, inter alia, take into account the following factors while considering such applications:

a. Prima facie viability of the JV / WOS outside India;
b. Contribution to external trade and other benefits which will accrue to India through such investment (or financial commitment) ;
c. Financial position and business track record of the Indian party and the foreign entity; and
d. Expertise and experience of the Indian party in the same or related line of activity as of the JV / WOS outside India.

Investments in Energy and Natural Resources Sector

Reserve Bank will consider applications for investment (or financial commitment) in JV/WOS overseas in the energy and natural resources sectors (e.g. oil, gas, coal and mineral ores) in excess of the prescribed limit of financial commitment. AD Category - I banks may forward such applications from their constituents to the Reserve Bank as per the laid down procedure.

Overseas Investments by Proprietorship Concerns

The following revised terms and conditions are required to be complied with for considering the proposal of overseas direct investment (or financial commitment), by a proprietorship concern / unregistered partnership firm in India, by the Reserve Bank under the approval route:

a. The proprietorship concern / unregistered partnership firm in India is classified as 'Status Holder' as per the Foreign Trade Policy issued by the Ministry of Commerce and Industry, Govt. of India from time to time;
b. The proprietorship concern / unregistered partnership firm in India has a proven track record, i.e., the export outstanding does not exceed 10% of the average export realisation of the preceding three years and a consistently high export performance;
c. The Authorised Dealer bank is satisfied that the proprietorship concern / unregistered partnership firm in India is KYC (Know Your Customer) compliant, engaged in the proposed business and has turnover as indicated;
d. The proprietorship concern / unregistered partnership firm in India has not come under the adverse notice of any Government agency like the Directorate of Enforcement, Central Bureau of Investigation, Income Tax Department, etc. and does not appear in the exporters' caution list of the Reserve Bank or in the list of defaulters to the banking system in India; and
e. The amount of proposed investment (or financial commitment) outside India does not exceed 10 per cent of the average of last three years' export realisation or 200 per cent of the net owned funds of the proprietorship concern / unregistered partnership firm in India, whichever is lower.

Overseas investment by Registered Trust / Society

Registered Trusts and Societies engaged in manufacturing / educational / hospital sector are allowed to make investment (or financial commitment) in the same sector(s) in a JV/WOS outside India, with the prior approval of the Reserve Bank. Trusts / Societies satisfying the eligibility criteria, as indicated below, may submit the application/s in Form ODI-Part I, through their AD Category - I bank/s, to the Reserve Bank of India.

Eligibility Criteria:

(a) Trust

i) The Trust should be registered under the Indian Trust Act, 1882;
ii) The Trust deed permits the proposed investment overseas;
iii) The proposed investment should be approved by the trustee/s;
iv) The AD Category – I bank is satisfied that the Trust is KYC (Know Your Customer) compliant and is engaged in a bonafide activity;
v) The Trust has been in existence at least for a period of three years;
vi) The Trust has not come under the adverse notice of any Regulatory / Enforcement agency like the Directorate of Enforcement, Central Bureau of Investigation (CBI), etc.

(b) Society

i) The Society should be registered under the Societies Registration Act, 1860.

ii) The Memorandum of Association and rules and regulations permit the Society to make the proposed investment which should also be approved by the governing body / council or a managing / executive committee.
iii) The AD Category - I bank is satisfied that the Society is KYC (Know Your Customer) compliant and is engaged in a bonafide activity;
iv) The Society has been in existence at least for a period of three years;
v) The Society has not come under the adverse notice of any Regulatory / Enforcement agency like the Directorate of Enforcement, CBI etc.

In addition to the registration, the AD Category – I bank should ensure that the special license/permission has been obtained by the applicant in case the activities require special license/ permission either from the Ministry of Home Affairs, Government of India or from the relevant local authority, as the case may be.

Guidelines for Foreign Collaboration Proposals

The Central Government has issued the following guidelines in connection with the formulation of proposals and agreements of foreign collaboration:

i) Alternative sources.-The collaborator should explore, to fullest extent possible, alternative sources of technology, evaluate them from a techno-economic point of view and furnish reasons for preferring a particular technology and the source of import.

ii) Other arrangement.-There should not be any restriction on the Indian Company in the matter of procurement of capital goods, components, spares, raw materials, pricing policy, selling arrangement, etc.

iii) Sub-licensing.-The Government expects that the technical collaboration agreement should generally not prohibit sub-licensing of the know-how, product-design or engineering design under agreement, to other Indian parties. Such sub-licensing, when it becomes necessary, is subject to terms to be mutually agreed by all parties concerned, including the foreign collaborator, and is subject to the approval of the Government. The collaboration agreements should not place any export restrictions to countries except where the collaborator has a sub-licensing agreement.

iv) Minimum royalty.-There should be no requirement for the payment of a minimum guaranteed royalty regardless of the quantum and value of production.

v) Exports.-To the fullest extent possible, there should be no restriction on free exports to all countries.

vi) Brand names.-There should be no provision for the use of the foreign brand names on the products for internal sale, although there is no objection to their use on products to be exported.

vii) Training-Research and development.-Adequate and suitable provisions should be made for the training of Indians in the fields of production and management. There should be adequate arrangement for research and development, engineering design, training of technological personnel, and other measures for the absorption and adoption and development of the imported technology. Such measures can be undertaken through in house facilities of the entrepreneur or in collaboration with recognised engineering design consultancy, research and development organisations in the public or private sectors, and recognised scientific and educational institutions where the necessary facilities exist.

viii) Consultancy service.-In case any consultancy is required to execute the project, it should be obtained from an Indian engineering consultancy firm. If a foreign consultancy firm is also considered necessary, an Indian consultancy firm should, nevertheless, be the prime consultant.

ix) Patent laws.-If the proposed item of manufacture is to be covered by a patent in India, it should be ensured that the collaboration agreement includes a clause to the effect that the payment of royalty for the use of the patent rights till the expiry of the life of the patent, and that the Indian party would have the freedom to produce the item even after the expiry of the collaboration agreement without any additional payment.

x) Indian laws.-Collaboration agreements will be subject to Indian laws.

xi) Extensions.-Government does not favour requests for extensions of the duration of collaboration proposals. All efforts should, therefore, be made to assimilate the technology within the initial duration of the agreement.