

## FOREIGN DIRECT INVESTMENT POLICY TWEAKED AMID COVID-19: A MOVE TO KEEP CHINA AT BAY

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Foreign Capital in India comprises majorly of Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). The real distinction between the two is that, FDI targets to take control of company in which the investment is made, FPI targets profit by investing in shares and bonds of the invested entity without any control in the company. FPI is investment in shares of a company not exceeding 10% of the total paid up capital of the company. Securities Exchange Board of India (SEBI) governs it.

Any investment above 10% is FDI as with that size of shareholding, the foreign investor

can exert control in the management of the company.<sup>1</sup> It is governed by Department for Promotion Industry and Internal Trade (DPIIT). Two routes namely, Automatic Route and Government/Approval Route regulate FDI in India. In Automatic Route, the sectors, which are specified, needs no prior permission from the Government of India or the Reserve Bank of India. The sectors not covered under the Automatic Route require a government approval regulated by Ministry of Economic Affairs. There are few sectors in which FDI is not allowed via any route, such as, Atomic Energy, Railway Transport etc.<sup>2</sup>

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### PREFERRED CITATION

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<sup>1</sup> Regulation 2 (xvii), (xix) of FEMA 20(R)/2017-RB

<sup>2</sup> Regulation 15 of FEMA 20(R)/2017-RB Unless otherwise specifically stated in the Act or the rules or regulations framed thereunder, investment by a person resident outside India is prohibited in:

- (1) Lottery Business including Government/ private lottery, online lotteries
- (2) Gambling and betting including casinos
- (3) Chit funds.

Explanation: The Registrar of Chits or an officer authorised by the state government in this behalf, may, in consultation with the State Government concerned, permit any chit fund to accept subscription from Non-resident Indians and Overseas Citizens of India who shall be eligible to subscribe, through banking channel and on non- repatriation basis, to such chit funds,

without limit subject to the conditions stipulated by the Reserve Bank of India from time to time

- (4) Nidhi company
- (5) Trading in Transferable Development Rights (TDRs)
- (6) Real Estate Business or Construction of Farm Houses.

Explanation: For the purpose of this regulation, “real estate business” shall not include development of townships, construction of residential /commercial premises, roads or bridges and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations 2014.

- (7) Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes

## Change in Law

The recent step taken by the Ministry of Finance, Government of India, is taken to keep a check on opportunistic takeover or acquisitions and clearly specifies that any Country sharing a land border with India can only invest through the Government Route. According to the press Note dated 17<sup>th</sup> April 2020<sup>3</sup>, the position of Para 3.1.1 of the present consolidated FDI policy is revised.

Earlier it mentioned, *“A non-resident entity can invest in India, subject to the FDI Policy except in those sectors/activities which are prohibited. However, a citizen of Bangladesh or an entity incorporated in Bangladesh can invest only under the Government route. Further, a citizen of Pakistan or an entity incorporated in Pakistan can invest, only under the Government route, in sectors/activities other than defence, space, atomic energy and sectors/activities prohibited for foreign investment.”*

Now, it doesn't only talks about Bangladesh and Pakistan but mentions every country

sharing land borders with India will have to invest through Government Route. Also, it has been very clearly specified in the press note that in case of transfer of ownership in cases of existing or future FDI will require government approval.<sup>4</sup>

This press note only talks about FDI and would not be applicable to FPI. Although, SEBI has asked the custodian banks to disclose Foreign Portfolio investors based in China and Hong-Kong.<sup>5</sup>

## Why the Need?

The countries sharing land boarders with India are Bangladesh, China, Pakistan, Bhutan, Nepal and Myanmar. This move by the Indian government is seen in light majorly focusing China and its growing investments in India. China's people Bank has invested heavily in the shares of HDFC Bank and has bought 1.75 crore shares worth 3000 crore this year itself. China has already funded more than two-dozen startups in

(8) Activities/ sectors not open to private sector investment e.g. (I) Atomic energy and (II) Railway operations

(9) Foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for Lottery Business and Gambling and Betting activities

<sup>3</sup> Press Note 3 (Series 2020); [https://dipp.gov.in/sites/default/files/pn3\\_2020.pdf](https://dipp.gov.in/sites/default/files/pn3_2020.pdf)

<sup>4</sup> Press Note 3: 3.1.1(a) A non-resident entity can invest in India, subject to the FDI Policy except in those sectors/activities which are prohibited. However, an entity of a country, which shares land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country, can invest only under the Government route. Further, a citizen of Pakistan or an

entity incorporated in Pakistan can invest, only under the Government route, in sectors/activities other than defence, space, atomic energy and sectors/activities prohibited for foreign investment. Page 1 of 2 3.1.1(b) In the event of the transfer of ownership of any existing or future FDI in an entity in India, directly or indirectly, resulting in the beneficial ownership falling within the restriction/purview of the para 3.1.1(a), such subsequent change in beneficial ownership will also require Government approval.

<sup>5</sup> Sebi seeks details of beneficiaries of FPIs from China, HK, April 15, 2020, The Economic Times; <https://economictimes.indiatimes.com/markets/stocks/news/sebi-seeks-details-of-beneficiaries-of-fpis-from-china-hk/articleshow/75148086.cms?from=mdr>

India. The executive Chairman of Alibaba group, Jack Ma, made 40% investment in government sponsored Paytm.<sup>6</sup>

The reason for amending the policy is this alarming rate of investment by China in India. Also, this step is taken, as there is a growing apprehension that the Chinese firm might take over Indian firms facing economic stress and slowdown in the times of Covid-19 pandemic. Vikram Dhoshi, Partner, Tax & Regulatory, PwC India has in his interview to Economic times pointed out that *“the government seems worried about the impact of Covid-19 on local business ownership and cross border takeovers and the press note is an attempt to place a check and give the government an opportunity to review such takeovers and investments coming into India from specific jurisdictions.”*<sup>7</sup> Various countries such as Australia, Germany, Italy and Spain have already put similar barriers for FDI during these times.<sup>8</sup>

### Key Outcomes and Conclusion

The major question here is that whether this press note is due to the pandemic or the

condition of prior approval shall remain thereafter. It is not clear as of yet that till when this prior approval continue. Three valid points established by Trilegal in there article, with respect to Impact on signed transactions or committed deals are essential to be looked upon.

It seeks clarity on the note and the effect it shall have on the finalized transactions, transactions that are signed but the completion has not taken place and also the transactions with multiple closings.<sup>9</sup> The key sensitive areas where the danger was high were healthcare, banking, telecom, technology and finance. But, the note covers each and every transaction relating to these countries. Whether it could have been relaxed in other sectors is a question.

The step taken by the Indian Government is highly criticized by China. Chinese Ambassador to India, Sun Weidong in series of tweets said that China was the first country to alert everyone about the pandemic and how it has supplied medical facilities

<sup>6</sup> China in Mind, Govt Tweaks FDI Policy to 'Discourage Opportunistic Investments' from Border Countries amid Covid-19 Pandemic, News 18; <https://www.news18.com/news/business/with-china-in-mind-centre-tweaks-fdi-policy-to-discourage-opportunistic-investments-in-indian-firms-amid-covid-19-pandemic-2583065.html>

<sup>7</sup> Government nod must for investment from China and its neighbors, April 18, 2020, The Economic Times; Read more at: [https://economictimes.indiatimes.com/news/economy/policy/india-steps-up-scrutiny-on-investment-from-china-and-its-neighbours/articleshow/75219816.cms?utm\\_source](https://economictimes.indiatimes.com/news/economy/policy/india-steps-up-scrutiny-on-investment-from-china-and-its-neighbours/articleshow/75219816.cms?utm_source)

[=contentofinterest&utm\\_medium=text&utm\\_campaign=cppst](#)

<sup>8</sup> Walling off China: India changes FDI policy to block threat, April 19, 2020, Times of India; <https://timesofindia.indiatimes.com/business/india-business/walling-off-china-india-changes-fdi-policy-to-block-threat-of-takeovers/articleshow/75227752.cms>

<sup>9</sup> India introduces stricter FDI rules for foreign investment from China and other border countries, April 20, 2020; Read more at: <https://www.trilegal.com/index.php/publications/update/india-introduces-strict-fdi-rules-for-foreign-investment-from-china-and-o>

throughout the world. He mentioned that, “in a time like this 'cooperation' was needed instead of 'scapegoating'.”<sup>10</sup>

FDI plays an important role in the economic development of India. It provides with job opportunities, expansion of Industries, raising the output, productivity etc. But, with growing concerns in the times of pandemic it is a welcoming step by the government. In late march, EU also came up with guidelines

concerning FDI. It was sated that, “The Commission urges Member States to be particularly vigilant to avoid that the current health crisis does not result in a sell-off of Europe’s business and industrial actors, including SMEs.”<sup>11</sup> These times are tough for India and it have affected the corporation’s technology, infrastructure and it is a time for the Indian government to be more vigilant and pro-active ensuring relevant checks are in place to save these companies.

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<sup>10</sup> China Issues Stung First Response After India Blocks Its FDI Under Automatic Route, April 19, 2020, Republic World; Read More at: [https:// www. republicworld. com/ world-news/ rest-of-the-world-news/chinese-ambassador-to-indias-first-response-on-indias-new-fdi-policy.html](https://www.republicworld.com/world-news/rest-of-the-world-news/chinese-ambassador-to-indias-first-response-on-indias-new-fdi-policy.html)

<sup>11</sup> Impact of Covid-19 On FDI Regimes, April 14, 2020; Read more at: [https:// www. bloombergquint. com/ coronavirus- outbreak/impact-of-covid-19-on-fdi-regimes](https://www.bloombergquint.com/coronavirus-outbreak/impact-of-covid-19-on-fdi-regimes)