

Date : 31 May 2005

Annexure I : Guidelines for Indian Direct Investment in Joint Ventures and Wholly Owned Subsidiaries Abroad

ANNEXURE I

Guidelines for Indian Direct Investment in Joint Ventures and Wholly Owned Subsidiaries Abroad

[Paragraph 9A.1]

Government of India_Ministry of Commerce

NOTIFICATION

File No.4/1/93-EP(01)

17th August, 1995

Introduction

1.1 Guidelines for Indian direct investment in Joint Ventures and Wholly Owned Subsidiaries abroad reflect the need for transparency, recognition of global developments, capturing of Indian realities and learning of lessons from the past experience.

1.1.1 Firstly, there is a need for a transparent policy framework to enable Indian businessmen to plan their business and to be able to react to potential collaborators outside the country. Such transparency is also required to enable the financial institutions and banks to assess their support through professional judgement in the context of financial sector reforms. Further, the non-resident Indian community which is expecting to play a strong role in globalising the Indian economy, in seeking a transparent policy.

1.1.2 Secondly, there is a need for a formal recognition of the changing global reality. These include: close relationship between flow of investment and trade, increasing role of medium sized units; success in the domestic economy as a precursor to success in the international arena; the importance of continuously updating the technology through cross investments; more dynamic relation between market seeking and resource seeking investments; tendency for skill and service intensity rather than material intensity in the international flows; the importance of going behind the tariff walls erected by the emerging regional blocs; the trend towards multi-country ownership of enterprises; and finally the emerging significance of ethnic links in

international investment and trade. It is also necessary to recognise that there can be a massive outflow of foreign investment by companies if not monitored carefully.

1.1.3 Thirdly, the Indian realities relate to the new economic policies. These include: strengthening globalisation of Indian economy by allowing the Indian entrepreneurship to go global; being a capital importing country, the need to avoid large capital outflows; visualising the global economic relationship well beyond physical exports; ensuring that Indian industry and business attain strategic positions in certain areas or regional blocs; increasing attention to Joint Ventures Abroad in third countries while finalising bilateral trade and economic relationships and the need for a more dynamic approach towards access to world technology through all means including overseas investment.

1.1.4 Fourthly, the lessons of experience have to be captured and a clear signal given about the new policy framework. The lessons of past experience include the low return on investment; large incidence of mortality after approval; low return on investment in the form of dividends; limited coverage and capital intensity of overseas investment, perhaps because they were linked with physical exports; inadequate coverage of trading and the service sector till recently; difficulties in obtaining clearance for cash borrowings and guarantees by the parent company in India, resulting in cash crunch experienced by the overseas venture; inadequate interaction between Embassies and investors; lack of self-regulatory mechanism; a regulatory approach instead of facilitator or strategic approach to overseas investment; procedural bottlenecks with clearance being required from multiple agencies; and finally the impression that approval of the government includes clearance from the commercial viability angle also and consequently implying directed lending by banking institutions resulting in defaults to Indian banks.

1.1.5 Liberalised outward investment procedures of 1992 have had a positive impact and approvals have increased in number, range and innovativeness.

1.2 The basic objectives of a transparent policy towards overseas investment from India through these guidelines are:

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. recognising the link between trade and investment flows, to provide a framework for Indian industry and business to access global networks.

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to ensure that such flows, though determined by commercial interests, are consistent with the macro-economic and balance of payment compulsions of the country, particularly in terms of the magnitude of the capital flows; and
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to provide a transparent mechanism of knowing the priorities of the Government in regard to the overseas investment, so as to influence the stakeholders including financial institutions/banking sector and Embassies so that there is an understanding and alignment between macro-economic objectives and the individual business decisions.
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to give liberal access to Indian business for technology-sourcing or resource-seeking or market-seeking as strategic responses to the emerging global opportunities for trade in goods or services.
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to give a signal that there is a qualitative change in the approach of the Government, from one of regulator or controller to one of facilitator.
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to encourage the Indian industry to adopt a spirit of self-regulation and collective effort for improving the image of Indian industry abroad.
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1.3 In the light of the above, the following guidelines are issued to elaborate the policy framework in the EXIM-policy. The Reserve Bank of India will accord all necessary approvals and monitor the progress by prescribing the reporting obligations.

Applicability

2.1 These guidelines shall apply to direct investment by Indian parties in joint ventures (JVs) and wholly owned subsidiaries (WOSs) abroad (hereinafter referred to as 'foreign concerns'). They apply to direct investment by Indian parties in newly promoted foreign concerns, to make initial

or additional direct investment by Indian parties in existing foreign concerns and to investments for acquisitions of overseas business.

2.2 The foreign concern in which the direct investment is proposed to be made may be engaged in industrial, commercial, trading or service activity including hotel or tourism industry. This includes financial services such as insurance, mutual funds etc.

2.3 These guidelines do not apply to -

- . portfolio investment by Indian parties in foreign concern;
- . direct investment in foreign concerns engaged in the banking sector;
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- . overseas direct investments funded out of EEFC balances up to a maximum of U.S.\$ 15 million permitted by authorised dealers; and
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- . overseas direct investment funded out of Global Depository Receipts (GDRs) up to a maximum of 50% of GDRs raised, permitted by Department of Economic Affairs, Ministry of Finance.

Cases under Serial Nos. (i) to (iv) will be considered in terms of separate procedures as prescribed by the Reserve Bank of India/Department of Economic Affairs (Ministry of Finance).

Definitions

3. For purposes of these guidelines:

- . 'direct investment' shall mean investment by an Indian party in the equity share capital of a foreign concern with a view to acquiring a long term interest in that concern. Besides the equity stake, such long term interest may be reflected through representation on the Board of Directors of the foreign concern and in the supply of technical know-how, capital goods, components, raw materials, etc. and managerial personnel to the foreign concern.
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- . 'Host country' shall mean the country in which the foreign concern receiving the direct investment is formed, registered or incorporated.
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'Indian party' shall mean a private or public limited company incorporated in accordance with the laws of India. When more than one Indian body corporate make a direct investment in a foreign concern, all the bodies corporate shall together constitute the 'Indian party'.

'Joint Venture' shall mean a foreign concern formed, registered or incorporated in accordance with the laws and regulations of the host country in which the Indian party makes a direct investment, whether such investment amounts to a majority or minority shareholding.

'Wholly Owned Subsidiary' shall mean a foreign concern formed, registered or incorporated in accordance with the laws and regulations of the host country whose entire equity share capital is owned by the Indian party.

Categories of Application Processed by RBI

4. There shall be two categories of applications for setting up overseas JVs and WOSs viz. category 'A': Fast Track and category 'B': Normal Cases. All applications are to be made to and processed by RBI.

Category 'A': Fast Track

5.1 An application for direct investment in a Joint Venture/Wholly Owned Subsidiary abroad from a private/public limited company will be eligible for automatic approval by Reserve Bank provided, (i) the total value of investment by the Indian party does not exceed (a) U.S.\$ 30 (thirty) million in respect of investment in SAARC countries and Myanmar; (b) Rs.120 (one hundred and twenty) crores in respect of Indian rupee investment in Nepal and Bhutan and (c) U.S.\$ 15 (fifteen) in all other cases, (ii) the amount of investment is up to 25% of annual average export/foreign exchange earnings of the Indian party (other than equity exports to existing JVs/WOSs abroad) in the preceding three years (not applicable to Indian rupee investments in Nepal and Bhutan as well as investment abroad by Indian software companies in the field of computer software as provided in sub-para (iv)) , (iii) in the case of investment in the field of computer software by Indian software companies with cumulative actual export/foreign exchange realisation of U.S.\$ 25 (twenty-five) million or more in the preceding three years, blanket investment approval may be given upto 50% of such export/foreign exchange realisation, subject to a maximum of U.S.\$ 25 (twenty-five) million in a block of three consecutive financial years, inclusive of investment upto U.S.\$ 15 (fifteen) million allowed by

authorised dealers out of EEFC accounts in terms of paragraph 2.3(iii) of the guidelines. The investment may, besides cash remittance at the discretion of the Indian party, be contributed by capitalisation in full or in part of -

- . Indian made plant, machinery, equipment and components supplied to the foreign concern;
- . the proceeds of goods exported by the Indian party to the foreign concern;
- . fees, royalties, commissions or other entitlements from the foreign concern for the supply of technical know-how, consultancy, managerial or other services.

In cases where the applicant company is a new company and does not have the requisite export performance/exchange earnings, credit may be given to the parent company's exports/exchange earnings, provided the applicant company is either a Wholly Owned Subsidiary of the exporting/exchange earning company, or the latter owns at least 51% shares in the former. In case of exports being routed through subsidiaries set up exclusively for international business, credit may be given to the parent company for the exports/exchange earnings of its subsidiary.

Apart from the above requirements, the following shall apply to applications for overseas direct investment in the financial sector :

- . financial services companies proposing to set up JV/WOS overseas should have a good track record of minimum three years and should either be registered with SEBI as Category I Merchant Banker or as NBFC under the Non-Banking Finance Companies (Reserve Bank) Directions, 1977 issued by Reserve Bank from time to time.
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In all cases at (i) above, the company should have a minimum net worth (paid-up capital + free reserves) of Rs.15 crores.
- . Financial companies seeking to make overseas investments should have fulfilled the prudential norms relating to capital adequacy ratio of 8%.
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Subsidiaries of Indian financial institutions which are conforming to the above said norms will also be permitted to make overseas direct investment in the financial services sector.

5.2 Within the overall limit of U.S.\$ 15 (fifteen) million, U.S.\$ 30 (thirty) million in case of investment in SAARC countries and Myanmar; U.S.\$ 25 (twenty five) million in case of Indian

computer software companies investing in the field of computer software, and Rs.120 (one hundred and twenty) crores in case of investment in Nepal and Bhutan may opt for (1) cash remittance, (2) capitalisation of export proceeds towards equity, or (3) giving loans or corporate guarantees to/on behalf of Indian JVs/WOS. Guarantees shall be taken at 50% of the face value for determining the overall limit of investments.

5.3 For loans/Guarantees from banks/financial institutions from India to/on behalf of Indian JVs/WOSs abroad requisite clearances from commercial banking angle for loans and guarantees as required would need to be taken as normally prescribed.

5.4 Where RBI in its judgement, feels that a proposal under automatic route is predominantly real estate-oriented; such proposals shall be remitted to the Special Committee.

5.5 All applications under the automatic route will be eligible for approval within 21 days of receipt of complete application by RBI, which shall include a broad feasibility study, a statement of credit-worthiness from a bank, and statement from a Chartered Accountant verifying the ratios, projections made, etc. In considering applications on the automatic route, RBI shall give due regard to the criteria laid down in [paragraph 7.1](#) below.

5.6 In case the application is for takeover or participation in an existing unit, the basis of share valuation shall be certified by a Chartered Accountant.

5.7 This facility of Fast Track route will be available to the Indian party only once in a block of three calendar years including the calendar year in which the investment is made. However, within the overall limit of U.S.\$ 15 (fifteen) million and its entitlement of 25% of average annual export/foreign exchange earnings [U.S.\$ 30 (thirty) million in case of investment in SAARC countries and Myanmar, U.S.\$ 25 (twenty five) million in case of Indian software companies investing in the field of computer software and Rs.120 (one hundred and twenty) crores in case of Rupee investment in Nepal and Bhutan], the Indian party may be permitted to invest in equity/provide guarantee, etc. on the fast track route on more than one occasion and in more than one JV/WOS abroad.

Category `B - Normal Cases

6.1 All applications not qualifying for fast track clearance on the basis of the applicable criteria outlined in para 5.1 above and all applications covered by para 5.4 will be processed in the RBI through a Special Committee appointed by RBI in consultation with Government and chaired by the Commerce Secretary with the Deputy Governor, RBI, as the Alternate Chairman. The Committee shall have as members, representatives of the Ministry of Commerce, Ministry of Finance, Ministry of External Affairs, Department of Company Affairs and RBI. The Committee

shall co-opt as members other Secretaries/institutions dealing with the sector to which the case before the Committee relates. A recommendation will be made within 60 days of receipt of the complete application and RBI will grant or refuse permission on the basis of the recommendations. Such proposals should be accompanied by a Project Report/Feasibility Report submitted by the applicant and by a statement from a Chartered Accountant verifying the ratios, projections made, etc. If the Special Committee is not satisfied with the Project Report submitted by the applicant, it may require the applicant to submit the project to an appraisal by an agency such as IDBI, ICICI, Exim Bank, SBI Cap or any other similar agency.

6.2 The Committee will, inter alia, review the criteria for and progress of all overseas investments under these guidelines and evolve its own procedures for consultations and approvals.

Criteria

7.1 In considering an application under Category 'B', the Committee shall, inter alia, have due regard to the following :

- . the financial position, standing and business track record of the Indian and foreign parties;
- . experience and track record of the Indian party in exports and its external orientation;
- . quantum of the proposed investment and size of the overseas venture in the context of the resources, net worth and scale of operations of the Indian party including the EEFC/GDR funds proposed as a component of the overseas direct investment.
- . Benefits to the country in terms of foreign exchange earnings, two way trade generation, technology transfer, access to raw materials and intermediates or final products not available in India; and
- . prima facie viability of the proposed investment provided that the proposals for overseas direct investment in the financial sector under Category 'B' shall also conform to the requirements laid down for this sector at paragraph 5.1 above.

7.2 Indian financial and banking institutions considering to support the venture will examine independently the commercial viability of the proposal.

Post Approval Changes

8.1 In the case of a joint venture in which the Indian party has a minority equity shareholding, the Indian party shall report to the Ministry of Commerce and the Reserve Bank of India the details of following decisions taken by the joint venture within 30 days of the approval of those decisions by the shareholders/promoters/Directors of the joint venture in terms of the local laws of the host country:

- . Undertake any activity different from the activity originally approved by the R.B.I./Government of India for the direct investment;
- . Participate in the equity capital of another concern;

- . Promote a subsidiary or a wholly owned subsidiary as a second generation foreign concern;

- . Alter its share capital structure, authorised or issued, or its shareholding pattern.

8.2 In the case of a joint venture in which the Indian party has a majority equity shareholding or in the case of a wholly owned subsidiary, the Indian party may, without prior reference to the R.B.I, consent to the following decisions being taken by the foreign concern, subject to the foreign concern having been in operation for not less than two years;

- . Undertake any activity different from the activity originally approved for the direct investment;
- . Participation in the equity capital of another concern;

- . Promote a subsidiary or a wholly owned subsidiary as a second generation concern;
- . Alter its share capital structure, authorised or issued, or its shareholding pattern.

Provided, the following conditions are fulfilled;

- . the Indian party has repatriated all entitlements due to it from the foreign concern, including dividends, fees and royalties and this is duly certified by a Chartered Accountant;

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the Indian party has no overdues older than 180 days from the foreign concern in respect of its exports to the latter;

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the Indian party does not seek any fresh cash remittance from India; and
the percentage of equity shareholding of the Indian party in the first generation joint venture or wholly owned subsidiary is not reduced, unless it is pursuant to the laws of the host country.

The Indian party shall report to the Ministry of Commerce and the Reserve Bank of India the details of the decisions taken by the joint venture or wholly owned subsidiary within 30 days of the approval of those decisions by the shareholders/promoters/Directors in terms of the local laws of the host country, together with a statement on the fulfillment of the conditions mentioned above.

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8.3 In the case of subscription by an Indian party to its entitlement of equity shares issued by a joint venture on Rights basis, or in the case of subscription by an Indian party to the issue of additional share capital by a joint venture or a wholly owned subsidiary, prior approval of the R.B.I shall be taken for such subscription. Approval for such subscription may be given in accordance with paragraph 5 or 6 above, as the case may be.

Large Investments

9. Investment proposals in excess of US\$ 15.00 million (not applicable to Indian Rupee investments in Nepal and Bhutan and investments abroad by Indian software companies as indicated in paragraph 5.1 above) will be considered if the required resources beyond US\$ 15.00 million are raised through EEFC funds/the GDR route. Upto 50% of GDR resources raised may be invested as equity in overseas joint ventures subject to specific approvals of the Government. Applications for investments beyond US\$ 15.00 million would be received in the RBI and transmitted to the Ministry of Finance for examination with the recommendations of the Special Committee. Each case would, with due regard to the criteria outlined in para 7, be subject to rigorous scrutiny to determine its overall benefit. Investments beyond US\$ 15.00 million without EEFC/GDR funding will be considered only in very exceptional circumstances

where a company has a strong track record of exports/other compelling benefits. All proposals under this category should be accompanied by the documentation as required for category 'B' under para 6.1.

Foreign Exchange

10. The foreign exchange needed for overseas investment may be drawn after the approval is granted, either from an authorised dealer or by utilising the balance available in the EEFC account of the Indian party or by any other means specified in the letter of approval.

Reporting

11.1 The Indian party shall furnish an annual performance report in respect of the foreign concern, together with a certified copy of its Annual Report and Audited Annual Accounts and a note on the basic features of the progress and achievements on the basis of original projections, within 30 days of the expiry of the statutory period for finalisation of audited annual accounts applicable in the host country to the R.B.I. The statutory period should be certified by an independent Chartered/Public Accountant of the host country. In case there is no such statutory period, the report shall be submitted within six months of the close of the relevant accounting period. Together with the annual performance report, the Indian party shall also furnish a detailed statement of all the entitlements due to it from a foreign concern and their remittance to India.

11.2 The Indian party shall remit to India in free foreign exchange (in Indian rupees for Indian Rupee Investment in Nepal) all entitlements due to it from foreign concern by way of royalty, technical fees, management fees or any other type of payments within a period of 60 days from the date they become due. The Indian party shall remit to India in free foreign exchange dividends/profit after tax due to it from a foreign concern within a period of 60 days from the date they are declared/approved by the Directors/shareholders of the foreign concern. The remittances mentioned above shall be subject to the time taken for clearance of the remittance by the Central Bank of the host country. In case the remittance of any entitlement mentioned in this paragraph has not been completed even within the following financial year of the foreign concern, the Indian party shall furnish a special report to the Reserve Bank of India explaining the reasons for non-remittance of the entitlements due to it from the foreign concern.

Disinvestment

12. Proposals for disinvestment from a JV/winding up of WOS will be processed by RBI. The application shall be accompanied by share valuation and justification for sale price as certified

by a Chartered Accountant.

Export of Indigenous Machinery towards Equity

13. Both under Category 'A' and Category 'B' above, second hand or reconditioned indigenous machinery may be supplied by the Indian party towards its contribution to the direct investment in the foreign concern.

Agency Commission

14. No agency commission shall be payable to a joint venture/wholly owned subsidiary against the exports made by the Indian party towards its equity investment. Similarly, no agency commission shall be payable to a trading joint venture/wholly owned subsidiary if the Indian party makes an outright sale to it.

Clearances under other Laws

15. Where the Indian party requires approval under the companies Act or any other law for the time being in force for the proposed direct investment, it would be the responsibility of the Indian party to obtain such approvals from the appropriate authorities.

16. The direct investment shall conform to the laws and regulations of the host country. It is desirable to associate, to the extent possible, local parties, local development banks, and local financial institutions in a joint venture. Unless there are strong reasons to the contrary, the association of individuals as foreign promoters or partners is not encouraged.

In Principle Approvals for Acquisitions

17. Indian parties seeking to acquire overseas ventures through time bound bidding/tender procedures are sometimes required to obtain 'in principle' approvals on an urgent basis. In such special circumstances RBI may grant such 'in principle' approval. RBI would formulate separate guidelines/conditions of application and approvals for such cases.

General

18. All direct investment in joint ventures and wholly owned subsidiaries abroad, whether approved under paragraph 5 or 6 of these guidelines, is subject to the provisions contained in these guidelines. If an Indian party violates any provision of these guidelines or fails to fulfil any of the conditions contained in the letter of approval, or if the RBI is satisfied that it is in the public interest to do so, the RBI may, without prejudice to any action under any other law applicable to

the case, direct the Indian party to disinvest its shareholding and remit all proceeds and other entitlements to India within a stipulated period.

19. The prescribed forms and other details may be obtained from all notified offices of Reserve Bank of India and filed in offices so notified.

Sd/-_(Ashok Pradhan)_Joint Secretary to the Government

Note: Amendments issued vide Ministry of Commerce Notification Nos.4/1/93-EP(OI) dated 7th and 19th November 1996, Notifications No.4/3/1997-EP(OI) dated 26th March 1997, No.4/3/97-EP(OI) dated 22nd August 1997 Notifications No.4/1/93-EP(OI) dated 16th April 1998, 29th August 1998, 14th September 1998, 2nd November 1998, 3rd May 1999 and 18th May 1999 have been incorporated in these guidelines.