

**CORPORATE  
PROFESSIONALS**

**FDI Policy- Rationale and  
Relevance of Caps-  
Suggestions on Issues for  
Consideration**

### 1) Do equity caps fulfill any purpose other than 'Control'?

Equity Cap may not fulfill the purpose of restricting Control in all cases.

In terms of the Consolidated Foreign Direct Investment Policy, a Company is said to be in Control of resident Indian if the resident Indian citizens and Indian companies, which are owned and controlled by resident Indian citizens, have power to appoint majority of its directors. Moreover a company is said to be owned by resident Indian citizens and Indian companies, if they own 51% or more of the paid up capital of the Company.

Further, an entity is considered as 'controlled' by non-resident entities, if the non-residents have the power to appoint a majority of its directors.

A Company is owned by shareholders and is managed by Board of Directors and in several cases the company is entirely managed by a professional board without having any interference of the shareholders. A company is controlled by its Board and therefore there can be cases where even equity caps don't serve the purpose of control. For example non-residents holding less than 51% of the company and representing 2 of out of 5 directors of the Company, can be controlling the Company, in case the MD is appointed by him and all major decisions of the company are taken by 2 directors and rest 3 directors either plays a passive role or not participating in the board meetings of the Company.

There can be cases where despite of not having majority in board of directors, the foreign shareholder by agreement, controls the entire management of the Company. Therefore even the equity caps cannot guarantee control of the company by person holding majority of shares.

***The other possible purpose of Equity Cap may be mandatory participation of Indians in certain class of businesses or assets. Government may feel it necessary that the benefits of certain resources being exploited must be shared with Indian citizens and hence put the condition of Equity cap on such sectors.***

**2) In the context of FDI policy, should those activities that can now be done indirectly, through downstream investments, as well be allowed to be done directly**

In cases where investment can be made indirectly breaching the equity caps, it is better to allow it directly but the government can control such breach of equity caps in the following manner:

- a) Any downstream investment by company with FDI more than 10 percent or 25 percent and where the foreign investor is having representation on the board of directors of the company should be treated as a FDI in proportion of foreign investment in the investee company
- b) Besides of power to appoint majority of director as criteria for considering control, following factors should also be considered :
  - i. Shareholding of more than 25%
  - ii. Power to take key decision and manage the affairs of the company
  - iii. To have negative control or veto rights
- c) A declaration by the shareholders to the person, who is in control of the company
- d) Disclosure of agreement between the shareholders, which deals with voting rights of directors & shareholders.

**3) If so, is there any relevance left for equity caps, especially below 49%**

No, there is no relevance left for Equity Caps in its present form, keeping in view the following:

- a) In spite of foreign resident holding being less than 49% of equity, Non-residents may be able to control & manage the company
- b) Due to the current regulations related to downstream investments, it is possible to breach the caps indirectly

But it is also to be seen that breaching of cap indirectly is also not an easy route, as the company making downstream investment should be operating cum investing company,

which means that the company should have operations and income from it, otherwise it will need to take approval of FIPB.

However, there are Sectors where it may not be appropriate to allow absolute foreign control. Thus, other ways of restricting the foreign holding and control has to be devised – allowing approval route or requiring detailed disclosures of control pattern, shareholding structure etc.

**4) Can the concerns supposed to be addressed by control through equity caps be addressed through sectoral conditions**

Yes, it can be done to an extent by providing conditions like

- a) Power to appointment MD/CEO shall vest with the majority partner.
- b) Power to make key decision shall vest with Directors appointed by the majority partner.

**5) If at all it is necessary to have caps in certain sectors, is it a better opinion to ask MNCs to list on Indian stock exchanges and then offload equity within a stipulated period**

The requirement of requiring company with FDI to offload stake by way of listing on stock exchange can only serve the following purpose

- a) Making Indian residents participate in the growth and wealth of the Company
- b) More Transparency in operation of company through various disclosures
- c) Better corporate governance

If these are the objectives to be achieved, then providing for such conditions make sense but such conditions can also act as deterrent towards attracting FDI in such sectors.

Moreover making company list on Stock Exchange, will make it widely held Company, thus, the effective control of Non-resident may be more easy with even lower percentage holding. Practically a listed company can be controlled with a shareholding much lower than 50% as it is next to impossible to gather all public shareholders for decision making. For any

decision making process only persons present and voting in the meeting are counted and not the total shareholders.

**6) As long as sectoral caps exist, should it be specified that they are exclusive of FII**

As per the Portfolio Investment Guidelines, the FII registered with SEBI can make Investment Company listed on recognized stock exchange through registered stock broker subject to certain limits. The purpose of portfolio investment is to trade in the shares of the company and because of small % of shareholding, there is no interest in the management or control of the affairs of the company. Moreover participation by FII in stock exchange brings more liquidity into the market.

Since the investment by FII cannot increase beyond 10 percent and such investments are not long term and hence unless FIIs have intention to participate in the business the limit for FII should be excluded from the sectoral caps.