COMMENTS

15 July 2011

**INDIAN MINISTRY OF COMMERCE AND INDUSTRY DEPARTMENT OF INDUSTRIAL POLICY AND PROMOTION:**

# DISCUSSION PAPER: FDI POLICY-RATIONALE AND RELEVANCE OF CAPS

## BUSINESSEUROPE COMMENTS

*Do equity caps fulfill any purpose other than "control", and if not should activities that can be done indirectly through downstream investment be allowed to be done directly? Additionally, do equity caps create an unfair opportunity for arbitrage?*
BUSINESSEUROPE does not believe that equity caps allow for healthy competition in markets. Equity caps distort markets making them less favorable to foreign investors. Equity caps limiting foreign investment to below 49% are especially damaging because they not only limit the potential return on investment by limiting the investment itself, but they also remove the ability of the investor to control that in which they invest. This acts as a drain on the Indian economy by causing investors to look to other markets with less growth potential, but fewer restrictions. Additionally, equity caps create an unfair opportunity for arbitrage by Indian investors by creating essentially two markets, one for foreign investors and one for domestic investors. Equity caps force foreign investors to invest in downstream investments in order to achieve the same results that they would achieve through direct investment. Unfortunately, the process of indirect investment reduces transparency in investment, harming both foreign and domestic investors.

India's progressive movement away from a positive list approach to a negative list should be applauded, and the reduction of equity caps in the economy has had a proven positive impact on industry growth. Equity caps that remain do impede investment and should be eliminated. Where deemed necessary and important to spur economic growth, consideration can surely be given to putting in place non-discriminatory regulatory approaches that are consistent with the path of economic reforms and growth and can be used to address underlying policy concerns.

Complicated equity cap structures which allow investment indirectly discourage FDI and can add confusion to governance structures, creating greater costs, reducing efficiencies and impeding innovation. Building predictability and transparency into an FDI policy that attracts foreign investment is broadly welcomed. This gives confidence to those seeking investment opportunities that the Indian economy remains a sound choice for FDI.

In general, equity caps, in particular those below 49 percent, represent a drag on economic growth and business activity, limiting the amount of capital in a country and making capital more expensive. The paper correctly identifies the differing ownership structures that effectively provide control even below 49 percent ownership. Any policy considerations that may have once created the rationale for equity caps now support regulatory and other non-discriminatory approaches that ensure investments provide value to the Indian economy.


AV. DE CORTENBERGH 168
BE-1000 BRUSSELS
BELGIUM
VAT BE 863 418 279

TEL +32(0)2 237 65 11
FAX +32(0)2 231 14 45
E-MAIL: MAIN@BUSINESSEUROPE.EU
WWW.BUSINESSEUROPE.EU

Equity caps distort market forces in ways that can make arbitrage more likely and are unhelpful to India's broader goals of promoting greater economic growth and development. By limiting full participation in certain sectors, equity caps create an artificial investing climate that can create unfair opportunities for speculators to use arbitrage techniques. Movement towards a more market-oriented investment strategy and eliminating equity caps provides greater choice and opportunity for investors and existing companies, as well as a more level playing field that does not unfairly aid some, rather than other, market actors.

*Can concerns supposed to be addressed by control through equity caps be addressed through sectoral conditions?*
BUSINESSEUROPE supports a level playing field for investors, regardless of their nation of origin. Equity caps on FDI discriminate against foreign investors. Should sectoral conditions maintain a level playing field, then they are preferable to equity caps. However, BUSINESSEUROPE believes that neither equity caps, nor sectoral conditions best serve the Indian economy.

Any concerns about the nature and conduct of an investment can be addressed effectively through targeted, non-discriminatory and appropriate regulatory and other frameworks that do not include equity caps. Indeed, regulatory and other frameworks can comprehensively deal with a number of issues, such as product safety and standards, by developing – with stakeholder's input – appropriate regulatory or other policy approaches that governs all investments, whether foreign or domestic. Such approaches, if applied fairly, without discrimination and with stakeholder's input, will often advance sectoral growth and innovation, particularly when there is abundant capital available through foreign investment.

*If at all it is necessary to have caps in certain sectors, is it a better option to ask MNCs to list on Indian stock exchanges and then offload equity within a stipulate period?*
BUSINESSEUROPE does not believe that it is appropriate to ask MNCs to list on the Indian stock exchange. While there are certain benefits to listing on the Indian stock exchange, such as a reduction in the scope of arbitrage possible by the Indian partner, these same benefits can be achieved through the abolition of equity caps. Additionally, asking MNCs to list on the Indian stock exchange and then oblige them to offload equity over a stipulated period would have a detrimental effect on the investment in India. It would indeed be a very bad signal to investors that they would be in fact obliged to disinvest from the listed company. Finally, it must be left to the discretion of MNCs where to establish their core business and from where to source their higher management positions.

Imposing listing obligations on an investment will discourage potential investors and have the effect of slowing an inflow of capital into areas where it is needed. Listing choices should be made by MNCs, themselves, in a manner that is beneficial to the company and therefore beneficial to the markets in which they operate and contribute technology, skills, employment and expertise.

The paper identifies India's twin goals of making "Indian companies global" and encouraging "MNCs to develop a long-term association with India." Requiring companies to list on Indian stock exchanges would undermine that second goal by likely discouraging some companies from engaging more actively in India's market.

Attracting strong and sustained international business interest in investing in India requires the establishment of a fair and predictable legal and business environment that invites investment and provides opportunities for India and the foreign investor to prosper and grow together.

*****