Open for business

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The Indian government recently announced several measures intended to revive the economy amid worries of a slowdown and very weak global markets. The measures include allowing 100% foreign direct investment (FDI) in the contract manufacturing sector, while regulations on local sourcing norms for foreign investment in single brand retail trading (SBRT), and 100% FDI under the automatic route for coal mining, have also been relaxed.

The government also imposed a 26% cap on FDI in the digital media sector, which has raised a few questions. All this information was contained in a press release, so it will be worthwhile to read the fine print on the changes, which are expected soon.

Single brand retail (SBRT)

Single brand retailers with a majority foreign shareholding were required to procure from India at least 30% of the value of their goods sold in the first five years. The government has now relaxed this requirement by counting any kind of procurement either by themselves or through their group companies from within India, even if such procurement was exclusively meant for exports, towards the local sourcing requirement. Any procurement made by third parties at the behest of SBRT companies under a contract, as well as any and all procurements (and not just year-on-year incremental increases in exports), would also count towards such local sourcing requirements.

The good news is that SBRT companies will no more be required to set up brick-and-mortar stores before starting online retailing. This allows companies to test market sentiment for their brands before making substantial capital expenditures. Most companies are apprehensive about making large investments unless they are certain, so this relaxation will provide a lot of strength in such decision-making processes for interested corporates.

The retail trading business is no longer a taboo for FDI, as the government has progressively relaxed this sector with a major boost that came in 2015, when e-commerce rules for FDI in SBRT were first relaxed. Since then, India has covered a lot of distance, as can be seen in the table.

With this recent announcement, companies in sectors like logistics, technology and fintech, consumer goods, business process outsourcing and many others will benefit. Even large multinational companies (MNCs) with significant brand value like Apple, IKEA and others will no longer hesitate to invest or further their existing investments in India, because not needing to have a brick-and-mortar store means they can start e-commerce and online portals without much investment, market study, strategy, etc.

Year	A timeline of recent FDI developments in SBRT
2019	100% automatic, subject to conditions (30% of local outsourcing norms relaxed)

2018	100% automatic, subject to conditions (30% of local outsourcing norms exists)
2017	49% automatic, and beyond that through the government approval route
2016	49% automatic, and beyond that through the government approval route
2015	49% automatic, and beyond that through the government approval route
2014	49% automatic, and beyond that through the government approval route
2012-13	100% through the government approval route
2010-11	51% FDI permitted through the government approval route

All this comes after the government took a tough stand for e-commerce players with FDI through press note No. 2/2018, issued last December, which stated that inventory of a vendor/seller would be deemed to be controlled by such an e-commerce entity if more than 25% of purchase of such vendor/ seller is from the e-commerce entity, including its group. This had forced many players to change structures, and had hindered planned investments for large e-commerce players like Amazon and Flipkart, which used to have preferred players, as these players had investments in such vendors.

Contract manufacturing

An interesting highlight is the way SBRT and contract manufacturing have been connected. The clarification and relaxations are likely to go hand-in-hand and nudge foreign investors to look at India more closely. While the relaxations have been allowed in SBRT, the government has, almost in the same breath, clarified that contract manufacturing will not just have 100% FDI under the automatic sector, but also that local sourcing made by contract manufacturers for or on behalf of SBRT companies would also count towards satisfying the requirements that SBRT companies have to fulfil.

Although there were no restrictions on FDI in contract manufacturing earlier, it wasn't expressly mentioned, and stakeholders had reached out to the government for clarity on the subject time and again. With the relaxation in FDI rules in light of the US-China trade war, and the government's focus on boosting local manufacturing, India has the potential to become a large contract manufacturing hub. This push has also been seen in other sectors, for example, the government only recently introduced a levy of safeguard duty on various items including solar modules for generation of solar power to discourage import and encourage local manufacturing of such goods.

Setting up the entire value chain for products is not easy, which is why companies both large and small rely on contract manufacturing. For example, Apple uses Wistron and Foxconn, Xiaomi uses Holitech and Foxconn, and Samsung and Oppo also use Foxconn. All such contract manufacturers are certainly set to benefit from this relaxation, either directly through infusion of FDI within their companies, or from contract value through FDI in SBRT.

India has been wanting foreign players to “Make in India” and sell not just in India but also outside, and these relaxations may well be just what the doctor ordered for the sector. In fact, only recently, on 20 September, the government also announced mega concessions for new manufacturing companies incorporated after 1 October 2019 to be taxed at 15%. This is substantially lower than current rates of 25% for new manufacturing companies, which was also brought down from 30%.

On the announcement date, while global markets continued to be weak, India’s Sensex jumped more than 2,200 points to close about 6% higher, which is easily Sensex’s biggest single-day gain in almost a decade. These changes will have to be implemented through amendments to the (Indian) Income Tax Act and the Finance Act, which largely control the direct tax regime in India.

Apple has already committed US$1 billion since the relaxation, and the funds are most likely to go into single brand itself, and a significant part towards contract manufacturing, since it will not be possible for Apple to break ties abruptly with its contract manufacturing partner, Wistron. Chinese electronics manufacturer, Holitech, had already announced a plan to invest US$140 million to set up a component manufacturing plant in India.

Similarly, Guoxuan JV China has tied up with Tata for a potential joint venture to manufacture battery packs for electric vehicles; the world’s largest EV maker, China’s BYD Co and Chinese battery manufacturer Contemporary Amperex Technology have committed large investments into manufacturing batteries in India; and the Bolivian government’s YLB Corporation has tied up with the Indian government’s KABIL for a potential joint venture to manufacture a lithium battery plant. With the most recent tax concessions, “Make in India” incentives, FDI relaxation, start-up drives, pushes for electric vehicles, etc., India is awaiting a series of investments in the months to come.

Coal mining

The government’s announcement also allows 100% FDI under the automatic route for the sale of coal and coal-mining activities including associated processing infrastructure, which includes coal washery, crushing, coal handling, and separation (magnetic and non-magnetic), subject to compliance of sectoral laws. This is in addition to the existing automatic permission for 100% FDI under the automatic route into coal and lignite mining for captive consumption by power projects, iron and steel and cement units and other eligible activities permitted under and subject to applicable laws and regulations, and also for setting up coal processing plants like washeries. This could come as a shot in the arm for the ailing coal-mining sector.

While this may be a saving grace for many as they start calling investors and conducting internal restructuring, it may not be great news for existing players like Coal India and others, who may risk losing customers and volumes.

Digital media

Among all these market-friendly reforms, one decision that may not have gone down well with businesses is the decision to impose a 26% FDI cap, under the government approval route, for uploading and streaming of news and current affairs through digital media outlets, bringing it on par with existing rules for print media. Industry representations and queries have already flooded the Information and Broadcasting Ministry on this.