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India's blueprint for tackling opportunistic acquisitions during COVID-19, with Chinese firms in mind*

by
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In April 2020, the Indian Department for Promotion of Industry and Internal Trade amended the Consolidated FDI Policy 2017 (revised FDI policy) with the objective to "curb opportunistic takeovers/acquisitions of Indian companies due to COVID-19."[1] The new policy requires government approval for investments emanating from all seven countries bordering India. The new element is that similar restrictions previously applicable only to Bangladesh and Pakistan are extended to other neighboring countries, with China a particular target. The recent foreign portfolio investment by the People's Bank of China in India's Housing Development Finance Corp. Ltd. (which raised the Bank's stake in the Indian mortgage lender from 0.8% to 1.01%[2]) is speculated to be the reason behind the revised policy.

Certain critical aspects of India's revised FDI policy include:

Blanket approval requirement. The revised FDI policy applies to all foreign investments made by entities of bordering countries. There is no minimum percentage threshold in a company's capital, or any other similar requirement, at which a foreign investment falls under the revised policy.

This directly undermines the new policy's objective, as it even affects established or minority investments with no shift in control to foreign investors. A better method for implementing this particular clause is found in Spain's guidelines regarding FDI restrictions. These specifically mention that acquisitions of 10% or more or control of companies by foreign investors fall under the restrictions. This excludes minority investments where there is no change of control from the hassle of government approval while curbing hostile M&As.

Applicability to all sectors. The revised FDI policy is applicable to all sectors. Unlike other countries, India's policy is not limited only to certain critical sectors such as healthcare and defense. For instance, the recent European Commission guidelines regarding the implementation of stricter FDI screening mechanisms to protect sensitive assets from foreign takeovers during the crisis is applicable only to such critical sectors as healthcare and research establishments. Applicability of the policy to all sectors might have a deterrent impact on FDI inflows. To fulfil its objective of safeguarding companies weakened due to COVID-19, the revised FDI policy should focus only on critical sectors affected severely by the pandemic or of national importance.

Retrospective application of the policy. The revised FDI policy is applicable to transfers of ownership of any "existing or future" FDI in an entity in India by firms located in bordering countries.[3] Such retrospective application of the policy may result in chaos for committed deals, where transaction documents have already been executed and large amounts of financial and human resources have already been utilized.

To avoid such difficulties, the government must set a cut-off date similar to that set by the Australian government to implement similar FDI policy to curb opportunistic M&As. This should specify that the amended rules will apply only to agreements and acquisitions that will not have been entered or completed until the specified cut-off date.

Business impact. Since China is the fastest-growing FDI source in Indian start-ups, requiring prior approval for investments from Chinese firms will make struggling start-ups wary of Chinese capital. China accounts for nearly 20% of all investments in Indian start-ups (primarily in tech start-ups), investing US$2 billion in 2018 and US$4 billion in 2019.[4] Losing these investments will have an impact disproportionate to its value, given the deepening penetration of technology in every sector in India.[5] Thus, given the uncertainties of a strict compliance process and intervention by India's government, the start-up industry is set to experience a substantial drop, taking the country's already weak GDP with it. The government should introduce a shorter and fixed approval timeline, especially for start-ups, to ensure timely investments.

Beneficial ownership test. The revised policy impacts more than bordering countries, as it provides that, in the event of the transfer of ownership of any existing or future FDI in an entity in India, directly or indirectly, resulting in beneficial ownership falling within the restriction, such subsequent change in beneficial ownership will also require government approval. However, the new policy does not define the terms "beneficial owner" or "beneficial ownership." Rule 2(1)(e) of the Companies (Significant Beneficial Owners) Rules, 2018 defines "significant beneficial owner" but it differs from the definition of "beneficial owner" under the Reserve Bank of India (Know Your Customer (KYC)) Directions, 2016. This needs clarification.

It remains to be seen whether these restrictions will continue after the pandemic, and what the possible outcomes will be of this strict FDI regime. Its objective to protect companies weakened by the pandemic or the resulting lockdown is understandable. But there are ambiguities in the new policy that must be clarified.

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[1] Ministry of Commerce and Industry, *Press Note 3 (2020 Series): FDI Policy*, Apr. 17, 2020.

[2] Sajeet Manhat, "China's central bank hikes stake in HDFC to more than 1%," Bloomberg Quint, Apr. 20, 2020.

[3] Ibid., p. 2.

[4] "With $4 billion Chinese investment, desi start-ups wary of FDI-policy tweak," *Times of India*, Apr. 19, 2020.

[5] Amit Bhandari, "China's strategic tech depth in India," *Gateway House*, Nov. 14, 2019.

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