FDI policy leaves investors jittery but DIPP open to review

The new revised consolidated FDI policy threatens to sour the investment climate even further. The Department of Industrial Policy and Promotion (DIPP) has aligned the new guidelines to the position taken by the RBI on the use of put and call options, reports CNBC-TV18's Sajeet Manghat.

DIPP revised its FDI policy as part of its regular mid-year review. On the face of it, the changes seem innocuous but a closer reading of the revised guidelines is giving foreign investors serious heartburn.

Nishchal Joshipura, Head - M&A Practice at Nishith Desai Associates said, "As for DIPP, any equity instrument or CCPS or CCD, if it is attached with any option then that wont be considered as an eligible instrument for FDI. It will be considered as an external commercial borrowing."

The new guidelines are aligned to the RBI's stance on treating options as debt and not equity. This will end the much used 'put & call option route' as an exit for private equity investors.

Joshipura added that the RBI has in the past shown its discomfort on the put options against the Indian promoters but the language which has been used in the new FDI policy is just options. "Unfortunately, the term options has not been defined under the FDI policy."

Managing director of Wolfensohn India Sanjiv Kapur said, "The risk premium has gone up everywhere. The expectation even in India of growth being more muted is apparent. So tweaking on how business should be conducted is untimely."

Managing Partner at Barring PE Rahul Bhasin said there is a need for an exit. "If you do not have agreements in place and you cannot have agreements in place which have penalty clauses for not having an exit being provided, then sooner or later, it will shut down the industry."

This does not necessarily stop here. Any joint venture or a strategic partnership arrangement will also be governed by these new guidelines. The right of first refusal, buybacks and other options that may be exercised in times of an exit for either parties in case of breach, default or a split.

Joshipura finds that many times in a joint venture scenario, one partner buys out the other joint venture partner. "All these exits are negotiated at the time of signing the agreement rather than waiting for the actual exit to happen at that point in time."

With options being barred, foreign investors, especially private equity funds, are holding back investment decisions hoping for a clarification from the government. The good news is, the DIPP is willing to look into the matter and is open to tweaking the FDI policy. Sources told CNBC-TV18 the clause was inserted at the last moment at the insistence of the RBI and the finance ministry. DIPP officials are sympathetic to the industry concerns and hope to take up this matter with the RBI and the finance ministry shortly.